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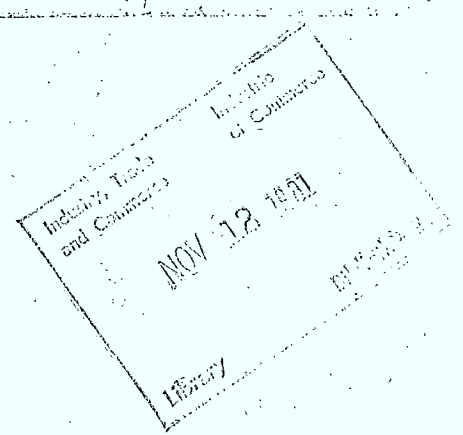
INTERIM REPORT

Canada.

DISTRIBUTIVE TRADES CONSULTATIVE COMMITTEE

SEPTEMBER, 1981

The Honourable Herb Gray,
P.C., M.P.
Minister of Industry, Trade
and Commerce
235 Queen Street
Ottawa, Ontario
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DISTRIBUTIVE TRADES CONSULTATIVE COMMITTEE
INTERIM REPORT

Dear Mr. Minister:

On April 16, 1981, the Distributive Trades Consultative Committee was established at your direction. I indicated to you that the Committee would endeavour to provide you with an Interim Report by the early fall, and would work towards the completion of a final report early in 1982. In fulfillment of the first part of that undertaking I now have the pleasure in enclosing the interim report of the Committee. Also included is a draft background profile paper on the sector prepared by the Distribution Services Branch (Appendix VI). This paper was reviewed by the Consultative Committee at its first meeting and we found it a very useful document in describing the sector and establishing the background for our deliberations. The Committee expects to be able to fulfill the second part of its obligations in a timely fashion also.

The Committee has included in its interim recommendations those subjects on which early action is clearly desirable. In some cases the recommendations have relevance to the forthcoming federal budget and it was felt necessary to bring forward the proposals at this time so that they could receive consideration during the period of policy formation prior to the budget. The selection of these particular items for the interim report does not imply that the other issues on which the Committee is working are in any sense less important. In the case of some of them, considerably more research and development is necessary prior to the formulation of concrete proposals.

The Sector

Common to all the participants in the Committee has been their recognition of the fact that the significance and influence of this industry tends to be severely underestimated by other sectors of the business community, by many in governments and, indeed by the population in general. They particularly asked me to record in this letter, although the facts are probably well known to you, Mr. Minister, some of the salient features of the industry which demonstrate its significance.

In fact, the industry is comprised of some 230,000 firms, employing an average of eight employees, indicating that small business is a strongly predominant feature of the sector. That statistic in itself, however, is somewhat misleading because the sector also embraces some of Canada's largest businesses, performing several billion dollars in sales and employing many thousands of employees. The distribution services sector provides employment for 1.8 million Canadians, representing some 17% of the Canadian workforce. In 1980, sales of the wholesale group were \$73 billion, trading houses \$5 billion, and the retail group \$89 billion (including automotive sales of \$24 billion and alcoholic beverages of \$3 billion). The growth rate for employment in the sector has averaged in excess of 3% per year over the decade 1970-1980 and, given a favourable economic environment, is likely to continue at that pace. Capital investment of the sector, other than real estate, is of the order of \$2.3 billion per annum.

These are impressive figures. Even more important is the fact that the success distribution has in fostering and satisfying demand has a profound effect on almost all of our goods producing industries and on the businesses which supply equipment and services to the trade. When retailing flourishes so does the manufacturing sector.

Yet, industrial and trade development in the sector has been largely taken for granted by government policy makers in both the provincial and federal areas of influence, on the general premise, presumably, that service industry development takes place automatically and efficiently in the wake of expansion of the commodity production sectors.

If this posture were ever justified, it is, in the opinion of the Distributive Trades Consultative Committee, no longer so. The economic environment, as it currently exists, is having deleterious effects on distribution which are difficult to overcome. Rapid and extensive advances in communications, management and marketing technology and the increasing needs of the industry for capital investment have radically altered the character of distribution. It is a sector of substantial economic importance, industrial strength and dynamism in itself. It acts as a generator and provider of many tens of thousands of new satisfying jobs each year. It is a vast outlet for entrepreneurial enterprise. It is one of the few businesses where an entrant with access to only modest capital can succeed and in a short space of time develop a sizeable business.

The encouraging growth that has been a principal feature of the sector's advancement in the past ten or fifteen years will continue into the foreseeable future if suitable encouragement is given the sector. Appropriate government policies and their intelligent implementation can significantly assist this sector to realise increasingly its potential for contributing to the economy of Canada.

A Continuing Advisory Vehicle

The members of the Consultative Committee have been unanimous in their view that the consultative process in which they are participating has the potential for bringing a much better understanding of the sector's needs and aspirations to the attention of the Federal Government and, indeed, through it other governments and sectors. The flow of information takes place both ways. Senior members of the trade have had the opportunity of gaining a better understanding of government objectives and policies in many areas.

It is the belief of this Committee that the positive results of this relationship are so significant that they should not be confined to the limited period of the life of the Committee. New issues and new priorities will obviously arise in the future in which it is important for government and private enterprise parties to have a good appreciation of the viewpoints of the other. It is this Committee's strong recommendation that prior to the end of its life, machinery be established for the regular periodic exchange of views between an all-industry senior consultative group and all appropriate elements of your Ministry. I know the members of the Committee would value the opportunity to discuss this subject with you at the appropriate time.

The Contribution of Those in the Distribution Services Workforce

It may seem unusual that, in an industry as labour-intensive as distribution, an item dealing with personnel functions does not appear as a recommendation in this interim report. The absence of such a topic should not be taken as a signal of any lack of interest or attention on the part of the Committee. In fact, a subcommittee has been working vigorously on the whole subject of people resource and is in the course of formulating a number of recommendations particularly related to training, skill development and recruitment. This will ensure that the distribution services sector will be seen as a positive place to pursue a rewarding career. The matter requires considerable research and the subcommittee's work is not sufficiently advanced to provide you with concrete proposals at this time.

Also, I should mention that in the case of labour relations, responsibility in the retail sector lies largely with the provincial governments. Members wish, meanwhile, to record their appreciation of the contribution made by the labour representative to the affairs of the Committee, and, of course, of the continuing contribution made by the almost two million employees, both in unionized and non-unionized sectors, whose dedication made the sector the efficient entity it is. To match this dedication with the development of skills necessary to improve productivity and to enhance career development in distribution is a primary concern of the committee.

Areas of Continuing Study

The Committee has established five sub-committees dealing with the following areas:

1. The Economic Environment Subcommittee (Chairman, Doug Tigert) is dealing with horizontal economic policy issues such as regulatory reform, market structure and conduct and financial indicators.
2. The Market Channel Links Subcommittee (Chairman, Ruby Osten) is investigating the impact of trade policy on distribution and a wide range of issues dealing with buyer/supplier relations.
3. The Distribution Systems Subcommittee (Chairman, Frank Warnock) is investigating various forms of distribution and new technologies.
4. The Human Resources Subcommittee (Chairman, Martin Goldberg) is progressing with the very complicated issue of training and human development.
5. The Energy Subcommittee (Chairman, Walter Hachborn) is focussing on the impact of energy requirements and changes on distribution.

I can assure you that recommendations will be coming forward from all these subcommittees for your consideration in the final report.

Design of Interim Report

The recommendations set out in the Interim Report are accompanied by a synopsis of the rationale behind them and a more detailed background paper expanding these arguments.

Excise Tax Recommendation

The Committee wishes to restate its earlier recommendation to the Minister on the matter of excise taxes. Specifically, it is the recommendation of the Committee that the shift to a wholesale tax on cosmetics be removed. The Committee realizes that there are some manufacturing functions conducted by importers which should have an excise tax imposed. However, a generally applied wholesale tax would be taxing service functions, which by all acceptable standards should be tax free. Any such shift of the excise tax would have serious negative repercussions on the distribution services sector and would establish a series of inequities in tax law which would be particularly onerous to small business.

Conclusion

May I take this opportunity of recording my personal thanks to my colleagues on the Committee for the very substantial contribution of time, effort and imagination which they have already contributed at this stage. I know I am assured of similar support from my colleagues

in the work ahead of us. On behalf of the Committee, I would also like to thank you for allowing us the opportunity to express our concern through the consultative committee process.

In presenting this Interim Report the Committee hopes that its recommendations will be carefully considered by you and your colleagues, and that their disposition be accorded priority. As I have previously mentioned, certain of the recommendations have implications for the forthcoming budget.

Respectfully Submitted,

T.G. Bolton
Chairman
Distributive Trades
Consultative Committee

INTERIM REPORT

EXECUTIVE SUMMARY

This interim report focusses on nine specific recommendations of the Distributive Trades Consultative Committee. These preliminary recommendations are made at this time in the hope that some of them will have an impact on the forthcoming budgetary process of the Federal Government.

Each recommendation is supported by the appropriate background material covering key issues, rationale and supporting documentation. Where possible, quantitative analyses have been made concerning the impact of the recommendations on the financial health of both the industry and the country. Each recommendation is addressed on a separate page, followed by supporting documentation in a series of appendices. The recommendations cover the following topics:

- i) accelerated writeoffs on various equipment categories;
- ii) accounting for inflation, the inventory tax credit adjustments and the move to LIFO accounting principles;
- iii) changes in the Small Business Loans Act and the Small Business Development Bond;
- iv) retention of the indexing of personal income tax;
- v) energy pricing and Federal/Provincial relationships;
- vi) amendments to the Combines Investigation Act;
- vii) deregulation in the trucking industry;
- viii) improvements in statistical data gathering and analysis by Statistics Canada;
- ix) distribution services contribution to adjustment agencies.

It is the position of the Committee that positive action by the government on these recommendations will greatly contribute to increased efficiency, productivity and the financial health of the distribution services sector and in so doing, will support the early recovery of the Canadian economy.

In support of these recommendations, there are a number of observations which the Committee wishes to bring to the attention of the government:

- (a) in spite of its size and importance, the distribution services sector has not been included in the mainstream of policy development, either by IT&C or by other federal departments. Any action taken to enhance the process by which the views of the distributive trades sector are taken into account in the formulation of government policy would result in substantial payoffs for both the trades and government. The Committee strongly advises that IT&C's position vis-a-vis the sector be strengthened on an ongoing basis. This expanded role needs to happen if both the sector and the government are to take advantage of the many opportunities for advancement which exist in each other's respective areas of interest;
- (b) the Committee views this formal consultative process as valuable, and is reviewing several options as to how consultation can be strengthened on a more permanent basis in the future;
- (c) the Committee recognizes that many of the issues it still has under discussion will not require government action but rather, must be addressed by the industry itself. Some examples include: improving the industry's image within the educational system; consumerism; and standard business practices.

It is the intention of the Committee to continue its deliberations through the remainder of this year and, early in 1982, provide the Minister of Industry, Trade and Commerce with a final report and recommendations on the subject matters which remain to be addressed.

DISTRIBUTIVE TRADES CONSULTATIVE COMMITTEE

INTERIM REPORT

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THE DISTRIBUTIVE TRADES CONSULTATIVE COMMITTEE

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Deputy Chairman
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Dean of Business School and Professor of Marketing
University of Toronto

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Mr. Frank Warnock
President and Chief Executive Officer
M. Loeb Ltd.

Mr. Martin Goldberg
President
Mareval Windsor Ltd.

Mr. Walter Hachborn
President and General Manager
Home Hardware

Mr. Miller Ayre
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Mr. Robert Yorston
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Dr. Vernon Smith
Mr. John Inns
M. Guy Gélinas
Mr. Fred Oxtoby
Mr. Tom Van Camp
Ms Patricia Morrison
M. Normand Levesque.

ACCELERATED WRITEOFFS

The Issues

Under the existing Canadian tax rules, manufacturing and processing firms have the right to write off new machinery and equipment over two years (accelerated capital costs allowances). This tax concession, implemented to encourage investment in order to stimulate manufacturing, and to partly offset the deleterious effects of inflation, does not apply to firms in the distribution services sector.

The Recommendations

1. The distinction between the distributive trades and the manufacturing sector held by Revenue Canada, with respect to accelerated depreciation, be eliminated.
2. More specifically, two-year writeoffs for tax purposes be extended to include such items as:
 - i) electronic front-end equipment (e.g. scanners and electronic cash registers)
 - ii) backroom computers/controllers and head office mainframe mini-computers
 - iii) computer software
 - iv) automated warehouse equipment
 - v) energy equipment such as refrigeration, heating, controls, lighting, etc., which leads to reduced energy consumption
3. Three year writeoffs should be allowed for fuel-efficient trucks.

Rationale (Appendix I)

The rising cost of labour, physical facilities, interest, and mechanical or electrical equipment within the distributive trades have narrowed any previous distinction between this service sector and the manufacturing/processing sectors. The adverse effects of inflation are universal. They cause profits to be artificially high and accumulated depreciation charges to be too low for inflated replacement costs. Consequently, the ability and willingness of firms to invest is inhibited, and the demand for Canadian end product manufactured goods is diminished. As unemployment problems become self-correcting in the 1980's, the sector's attention will increasingly turn towards increased efficiency and productivity.

Firms in the distributive trades sector, by being excluded from the two-year writeoff provision, have not been able to improve efficiency, reduce cost, and exert downward pressure on prices to the extent that would have been possible with larger investments in energy-saving, labour-saving and automated time-saving equipment and machinery. Accelerated writeoffs would stimulate both demand for and supply of such equipment.

ACCOUNTING FOR INFLATION

The Issue

The current 3 percent inventory tax credit, established in the past to counteract inflationary pressures on the rising cost of carrying inventory, is no longer adequate.

The Recommendations

1. Short-Run: The inventory tax credit be raised from 3 percent to 10 percent to more closely parallel the effects of a shift from FIFO to LIFO accounting procedures already adopted in the U.S., and to more closely parallel the true impact of the current inflation rates on the overstating of corporate incomes.
2. Long-Run: The accounting principles in Canada be gradually changed to methods of financial reporting and tax assessment which are better able to reflect the effects of inflation on the corporate financial position. The LIFO system eventually adopted should pay attention to simplification of accounting procedures.

The Rationale (Appendix II)

The supporting documentation clearly shows that the introduction of the 3 percent inventory tax credit was a very positive move on the part of the government (Appendix II). This was based on a move towards fair tax treatment for business at a point in time when inflation was projected in the order of seven percent per annum. However, between 1977 and 1980 the impact of the 3 percent level has been to reduce the benefit from approximately 43 percent LIFO equivalency to only 29 percent LIFO equivalency. The 3 percent tax credit is much easier to implement than LIFO accounting but any inventory tax credit encourages firms to hold very large inventory levels at least once a year. Thus, while we recommend a short-term solution of moving from 3 to 10 percent tax credit, our preferred solution is to go to full LIFO accounting at the earliest opportunity. LIFO accounting evaluates inventory at full replacement cost and has the impact of eliminating corporate taxes on phantom profits while simultaneously increasing cash flow.

A number of countries, in addition to the U.S. have already moved to LIFO accounting or to an equivalent accounting principle in recognition of the insidious impact of inflation in overstating corporate profits. These countries include Australia, Belgium, Italy, Japan, Spain.

SMALL BUSINESS LOANS ACT AND SMALL BUSINESS DEVELOPMENT BOND

The Issues

At present, both of these federal government assistance programs do not allow for loans on the basis of working capital requirements, but rather for investments in plant and equipment. In the distribution services sector, the primary investment objective is for working capital, most of which is represented by inventory investment.

The Recommendations

1. SBLA loans be made available for working capital.
2. Financing under the Small Business Development Bond (SBDB) be used for working capital.
3. The SBDB time frame should be extended indefinitely and be utilized up to a maximum of \$500,000 in as many individual bonds as retailers and wholesalers need to develop their business potential over time. In other words, retailers and wholesalers should be allowed to finance a series of bonds up to the \$500,000 level as their business matures.
4. The federal government should utilize some of its large advertising budget to promote a much wider level of awareness to the business community...both for the SBDB and the SBLA. In addition, the commercial banks should be encouraged to broaden their participation in these loan programs.
5. The terms of the SBDB should be extended to 1990.

The Rationale

Most small business in the distribution services sector do not start off with capital requirements in the \$500,000 range. As they expand, into a third or fourth store, or into additional warehouse facilities, their capital requirements are sequential. Allowing for a series of smaller bonds, up to the \$500,000 maximum, would facilitate their orderly growth.

More important, many retailers lease their physical facilities. Their key working capital requirements are for leasehold improvements, electronic equipment and inventory. Depending on the rate of inventory turnover, inventory investment could represent upwards of 80 percent of working capital requirements. High interest rates are just as devastating to low turnover retailers as they are to the manufacturing or resource sectors in Canada. Provisions for SBDB financing at a rate of half of prime + 1 would be a major benefit to retailers and wholesalers.

INDEXING OF PERSONAL INCOME TAX

The Issue

There is a strong threat that the indexation feature of personal income tax will be removed or emasculated in the Fall/81 budget. That removal would squeeze consumer expenditures to the point where a large number of wholesale and retail businesses, especially the smaller ones, would be in serious financial difficulty.

The Recommendation

The indexation feature of the personal income tax should be retained in its present form. The recent oil price agreement should substantially alleviate the cash flow problems of the federal government. This agreement will, in itself, reduce consumer expenditures on other goods and services (see Appendix III, table 3). Thus, both the consumer and the consumer goods producing and distribution sectors would be in double jeopardy should the current indexation formulas on personal income tax be removed.

The Rationale

The Committee finds it repugnant that the body which has the task of providing leadership in the fight against inflation - Government - should become a covert beneficiary of its malign growth.

Projections made within the Economic Council's "Candide" econometric model show that de-indexation would substantially reduce total real consumer expenditures during the 1980's, by about 2% per annum. Declining real incomes would put immediate pressure on unemployment as consumer spending declined. Declining real incomes would also push up wage demands (and justifiably so) to compensate for declining incomes. The wage push spiral could become insidious and lead to runaway inflation.

Finally, we observe that the U.S. is moving both to cuts in personal income tax but also to imposition of the indexing feature by 1985 at a time when Canada is considering removal of the very same feature.

THE NATIONAL ENERGY PROGRAM

The Issues

The National Energy Program, while progressive in both its intentions and its scope, has to date had a very negative impact on the economy by eroding the confidence in Canada both inside and outside the country. The current situation of a country, with enormous resources and yet a net importer of high-priced oil, is viewed as intolerable.

The Recommendations

(Formulated prior to recent oil pricing agreements --see following Note)

1. The National Energy Program be amended so that Canadian wellhead prices for oil reach 75 percent of the F.O.B. international price by 1985 (projected to be \$62.99), and be tied to the world price at that ratio thereafter.
2. That efforts be redoubled to secure a solution to energy pricing and revenue sharing agreement between the Federal and provincial governments and the producers at the earliest possible opportunity.
3. The oil sand projects (Alsands, Cold Lake and Petro Canada) be undertaken as quickly as possible, and a scheduling commitment be obtained from the sponsoring oil companies in light of higher oil prices, revenues and rising development costs.
4. In recognition of the enormous shifts required to reach self-sufficiency, energy/usage shares be monitored closely and that programs be adjusted where necessary to ensure that the objectives on oil substitution are achieved.

The Rationale (Appendix III)

It is the Committee's view that the energy program appears to have placed undue emphasis on protecting consumers from high oil prices while jeopardizing the objective of security of supply and self-sufficiency. The Committee considers the current policies to be inadequate to encourage conservation, substitution and exploration and development. An extensive analysis, through the Candide model, has indicated a substantial negative impact on consumer spending through higher oil prices but a more than compensatory benefits in the form of reduced federal deficits, growth in the economy over the long run and a healthier investment climate, as well as a faster movement towards energy self-sufficiency.

NOTE: As a result of the recent oil pricing agreement between the federal government and Alberta, some of our concerns have been addressed. In particular, the settling of the oil pricing dispute and the increase in Canadian oil prices to more realistic levels are matters which this committee considered essential for the economic well-being of Canada. The higher oil prices will certainly have a negative effect on consumer spending and thus on the distribution services sector. However, it is a price the committee is sure all distributors are willing to pay for the chance of achieving security of supply and in turn, economic stability.

RESPONSE TO THE PROPOSED AMENDMENTS TO THE COMBINES LEGISLATION

The Issues

There is a shared concern about the inability of the current Combines legislation to deal with the fairly rapid pace of mergers/acquisitions in Canada. However, there is even more concern about the nature and direction of the proposed amendments to the existing legislation, especially given the situation that the distributive trades were not extensively involved in the deliberations about those changes, and given that this sector may be adversely affected by the proposed changes. Some of the proposed changes are totally unworkable for smaller trading areas, for certain well established competitive marketing practices, etc. Further, there is a lack of specificity in the proposed definitions of products, markets, retailers, etc.

The Recommendations:

1. The direction contemplated in the proposed amendments with respect to monopoly power be changed in favour of an approach which deals with misuse of a dominant position in the case of mergers and acquisitions.
2. Certain proposed examples of anti-competitive behaviour may well be examples of pro-competitive behaviour and should be reconsidered. They include "fighting brands", (e.g. generics), selective price-cutting (e.g. weekly specials), market saturation advertising, etc.
3. The Committee supports the June 29th, 1981 submission of the Retail Council of Canada to the Minister for Consumer and Corporate Affairs (see summary in appendix) and requests additional consultation with the distribution services sector before any proposed changes in the legislation are tabled in Parliament.

Rationale
(Appendix IV)

The proposed amendments argue for a simplistic definition of market concentration based on a single firm or a four-firm concentration ratio. In many small communities, there may well be only one firm in certain products line. In larger communities, the retail trading area might well support only three firms for specific product classes. There are also serious problems with the definition of "market" and serious concerns that the proposed amendments have not considered the concept of product/market boundaries at the commodity level. The Committee's view is that competition should be examined and analyzed primarily at the commodity level.

DEREGULATION IN THE TRUCKING INDUSTRY

The Issues

The myriad of federal and provincial regulations affecting both private and "for-hire" trucking fleets has led to inefficient use of capacity elimination of many two-way hauling trips and the consequent higher cost/higher pricing structure within the distribution services sector.

The Recommendations

1. The Committee recommends the adoption of the following recommendations made by the Economic Council of Canada in its report entitled "Reforming Regulations - 1981".
 - i) all regulatory restrictions on the operating freedom of existing for-hire motor carriers be removed.
 - ii) in place of the present cumbersome and often costly process whereby applicants for trucking licenses must establish that their service is for "public convenience and necessity," the regulatory board maintain requirements with respect to such matters as bonding, insurance, and vehicle registration and that they issue licences on a "first-come" basis.
 - iii) that price regulation and the formal requirements for rate filing in trucking be abolished. The provincial regulatory boards should, however, retain broad powers to obtain rate information from individual carriers when they deem it necessary.
 - iv) the definition of private carriage in trucking be expanded to include transport by member of a corporate family where the affiliate firms are effectively controlled by a parent corporation.
2. The Committee recommends that private carriers be permitted to move goods for compensation on the backhaul portion of their journey.

3. The Committee recommends that the report by the Economic Council on Reforming Regulation (1981), and in particular, the sections on trucking deregulation, be a priority item of the next First Ministers' meeting. Further, the Committee recommends that the First Ministers acknowledge the need for deregulation and take steps to set in motion the governmental apparatus necessary to deregulate the trucking industry.

The Rationale

Rising interest rates have forced the Distributive Trades to seek ways to keep inventories down and to turn inventories faster. Improved delivery schedules are one method of achieving these objectives. But with the rising costs of energy, suppliers have tried to keep costs down by consolidating shipments and reducing deliveries. Thus often suppliers, not retailers, control the timing of deliveries.

This situation has led retailers (who are not already operating fleets) to evaluating on a cost/benefit analysis basis, the possibility of operating their own "in-house" truck distribution fleet. However, regulations governing back-haul and compensation possibilities for private fleets have discouraged many retailers from developing private fleets. These restrictions, which generally prevent firms from handling the goods of other firms, including corporate affiliates and subsidiaries, prevent efficiency in energy consumption. In addition, for-hire fleets have been burdened by excessive regulations across a number of areas including rates, licensing, and route structure. The end result has been higher costs, higher retail prices and inefficient transportation systems in the trucking area.

IMPROVEMENTS IN STATISTICAL DATA GATHERING AND ANALYSES
BY STATISTICS CANADA

The Issue

In an era of "scrambled merchandising" and development of whole new retail and wholesale sectors (such as home improvement centres), the data provided by Statistics Canada on the distribution services sector has become obsolete. Major improvements are needed if the sector is to be provided with timely and useful data on which to make important strategic decisions.

The Recommendations:

Statistics Canada should totally review its efforts in the distribution services sector in terms of :

- 1) reversal of the decision to cancel the 1981 census of merchandising
- 2) definitions of commodity categories and trading area boundaries
- 3) what is collected, how often and from what geographic territory
- 4) definitions of retailers and of independents versus chains
- 5) the establishment of a permanent consultative users group within the distributive trades to interact with Statistics Canada on an ongoing basis. Potential subjects might include:
 - i) weekly or monthly reporting of department and chain store sales by major "kinds of business" categories;
 - ii) annual financial operating ratios;
 - iii) annual or bi-annual reports of shopping centre developments to track major structural changes in the industry;
 - iv) monthly retail trade estimates expanded to cover other census metropolitan areas (such as Calgary, Edmonton, Hamilton, etc.);
 - v) periodic merchandise inventory levels;
 - vi) labour force breakdowns by sector or sub-sector.

Rationale
(Appendix V)

Almost all of these recommendations were made by a task force of information users, who directed a paper to the Chief Statistician in 1978. All are still relevant today. The private sector makes use of these types of data in determining industry trends, economic locations of new stores, warehouses, shopping centres and manufacturing facilities. It uses the data to understand underlying shifts in population patterns, shifting shopping patterns and to measure market potential. Federal, provincial and municipal governments use the same data for planning and urban development.

DISTRIBUTION SERVICES CONTRIBUTION TO ADJUSTMENT AGENCIES

The Issue

The Canadian Government instituted quota protection systems as part of a program of support for the Apparel, Textile and Footwear manufacturing sectors. A recently announced adjustment program for the apparel/textile sector (one is likely to be introduced for footwear also) does not appropriately recognize either the policy support which can be provided by the distribution services sector or the impact trade restrictions have on this sector.

Recommendations

1. The new agency established to administer the textile and clothing sector adjustment program include on the Board distribution services sector representation and provide continual consultation with that sector.
2. Similar agencies, if established, for example on footwear, need distribution services sector representation.

The Rationale

In the announcement outlining the new policy for the textile and clothing sector, Messrs. Gray and DeBané indicated that the industry was to restructure towards more viable lines of production. The agency to be established to administer the program and provide a service for firms requiring modernization and restructuring will "decide the merits of company applications and allocate its resources accordingly".

For a manufacturing firm to be viable, there must be a market for its products. While retailers are ostensibly the purchasers of the output from the Canadian clothing manufacturers, they, of course, are re-selling to the ultimate consumer. Retailers' livelihood depends on an accurate interpretation of the needs, demands, purchasing power, fashion consciousness and the vagaries of the consumer. Because of this, they are in the best position to provide a marketing orientation and appropriate input to the deliberations of the agency. The lack of such a perspective appears to have been a factor contributing to the current difficulties of those manufacturing sectors.

In addition, the adjustment agency is charged with encouraging new firms (from other sectors) to locate in areas in which there may be a surplus of workers due to restructuring, and to assist in the job relocation process. Members of the distribution sector, which is a large employer, generator of capital investment and utilizer of new technology, are ideally suited to assist in this process also.

APPENDICES

- I. Accelerated Writeoffs
- II. The Impact of Inventory Accounting Procedures on Distributive Trades
The Effect of the 3% Inventory Tax Credit
Tax Treatment of Inventories: OECD Countries
- III. Energy Sub-Committee Report
Economic Impact of Proposed Oil Pricing Schedule
- IV. Response to Competition Legislation
- V. Distributive Trades: Statistical Needs
- VI. The Distributive Trades: Wholesale and Retail Industries of the 1980s.

APPENDIX I

ACCELERATED WRITE-OFFS

In 1972, the Minister of Finance introduced a provision giving manufacturing and processing firms the right to write off new machinery and equipment over two years. This tax concession was implemented to partly offset the deleterious effects of inflation, but more importantly, was an attempt to stimulate investment, and, consequently, the manufacturing sector.

The cost of depreciable assets is normally amortized against profits through annual depreciation charges over the course of the useful (or accounting) life of an asset. This enables a firm to withhold sufficient resources to replace the depreciable assets when their useful life has ended. During periods of inflation, because depreciation must be based on historical rather than replacement cost, the accumulated depreciation charges fall far short of replacement cost.

Chronic inflation of the kind Canada has experienced during the past and present decade creates a number of adverse consequences for a firm:

- (1) An additional tax burden is imposed on a firm since the capital cost allowance (depreciation) it may charge against taxable income has become increasingly inadequate.
- (2) The shortfall in depreciation charges lead to overstated distributable earnings causing the payment of excessive dividends, and impair a firm's financial position.
- (3) A firm's accumulated depreciation becomes insufficient in relation to ultimate replacement cost, leading to postponed and reduced investment, and declining efficiency.

The effects of inflation on profits and investment are as pernicious for firms in the distribution services sector as for firms in manufacturing and processing, but the sector is unable to take advantage of the two-year write-offs and is consequently placed in an unfair tax situation. Consequently, relative to firms in other sectors, the taxable profits of firms in the distributive trades are artificially high, the accumulated capital cost allowances are too low, and the incentive and ability of the firms to invest have been reduced. The distributive trades sector is encountering these disadvantages at a time when there is a special need for increased investment in energy-saving processes and equipment, in labour-saving electronic equipment, in cost-saving automated warehouse and

goods-handling machinery and equipment. In short, the distribution services sector is moving towards a more capital intense position to parallel the manufacturing sector. The ability of firms trades to increase productivity and improve efficiency has been hampered, the upward pressure on prices has not been mitigated, and the demand for energy-saving, electronic and mechanical equipment from the thousands of firms in the distributive trades has been lower than would have been the case under accelerated write-offs.

An accelerated capital cost allowance would help to ameliorate the investment climate under which wholesalers and retailers conduct their business. At the same time, no tax revenue is irrevocably lost by permitting accelerated write-offs. Advancing the claiming of the capital cost allowance shields otherwise taxable income from tax in the years that the accelerated write-offs accrue, and allows the potential of a more positive cash flow to the sector, which can be used to lower prices and/or stimulate demand for manufactured goods.

In later years, firms which have claimed accelerated write-offs would have more of their income exposed to tax because the "shield" of normal capital cost allowance is not available; however, judicious decision-makers will have made their companies more productive and efficient. With a negative economic environment being established (re consumer dollars going to energy as opposed to consumer goods), this kind of measure is particularly needed at this time.

APPENDIX II - 1

THE IMPACT OF INVENTORY ACCOUNTING PROCEDURES ON
THE DISTRIBUTIVE TRADES

Relationship between inflation, real incomes and cash flows of firms, and tax policy is becoming increasingly well known. Current Canadian accounting practices by definition creates gaps between real values of assets and liabilities and the nominal values reported in financial statements. Under existing tax rules inflation results in the imposition of additional tax burdens, to the extent that in highly inflationary times, business decisions on investment and inventory level are interpreted in a negative fashion. The fundamental problem is that, before a business can report earnings on capital invested, it must provide out of earnings for all the costs associated with maintaining that capital (or inventory).

While inflation affects depreciation, for distributors the main impact of inflation lies in inventory valuation. For many retailers, inventory is the major asset they have and in most cases this is already financed. To pay tax on phantom income becomes particularly onerous. Tax laws dictate that for inventory accounting, goods are sold in sequence in which they were purchased. The following insidious effects of inflation are widely recognized:

- (i) Taxable profits are overstated, because cost of sales (inventory) is understated,
- (ii) the implicit cost of holding inventory is increased and an incentive exists for firms to reduce their inventory (equally applicable to manufacturers),
- (iii) overall cash flow is reduced,
- (iv) the possibility exists that firms overstate distributable earnings and pay excessive dividends,
- (v) management would be taking decisions on apparent cash flows rather than on real returns and, for small business in particular, liquidity problems arise, and
- (iv) more and more companies are being forced into greater dependance on financial markets.

All decision makers need to be aware that conventional accounting practices can be very misleading and can mask situations where both inventory and capital can be frittered away.

In support of the recommendations, a review illustrating the situation in other countries is attached. (Appendix II ~ 2)* In most countries, this problem is approached by an augmentation of traditional financial statements.

In Canada, 1977 saw a partial solution to the problem. The government introduced an inventory deduction of 3 percent of opening inventories which does give significant benefit to distribution businesses from spurious inventory profits. The effect of this has been a reduction on their taxable income and improved liquidity and cash flow.

An analysis of the results of the 3% inventory credit and the last-in-first-out inventory (LIFO) accounting was done based on what would have happened if all companies had used LIFO.** In all years reported the taxes saved with the inventory deduction would have been only a percentage of the maximum taxes that could have been saved by LIFO (LIFO being a true indicator of real taxable profits). As inflation rates rise, the inventory deduction becomes less suitable as a mechanism to resolve the problem.

* Prepared by Financial Policy & Liaison Branch, IT&C, August 1981

** Prepared by Distribution Services Branch, IT&C, August 1981.

APPENDIX II -2

TAX TREATMENT OF INVENTORIES
OECD NATIONSAustralia

Inventory may be valued at cost (full absorption cost) market selling value or replacement value, which serves the same end as would a LIFO accountin system.

Austria

The inventory for tax reporting purposes must agree with the books. Inventory must be valued on a moving average basis and other methods (e.g. LIFO) are only permitted if they accord with the facts.

Belgium

Inventories usually stated at the lower of cost or market. LIFO is accepted for tax purposes.

Denmark

Lower of cost or market replacement. Inventories so stated may be written down by 30% for tax purposes. A write-down need not be reflected in the books. LIFO is not permitted for tax purposes.

Finland

Inventories may be written down to 50% of lowest of direct FIFO cost, replacement cost less obsolesence or net realizable value.

France

Inventories must be valued at the lowest of cost or market. Cost must be determined in accordance with FIFO or average cost methods. The LIFO method is not permitted.

Germany (Federal Republic)

Inventories are normally valued at the lower of cost or actual cost, replacement cost or net realizable value. Both FIFO and LIFO are not acceptable for tax purposes unless it is shown that the method accords with the facts.

Greece

Inventories are stated at the lower of cost or market (replacement value). LIFO is not permitted.

Ireland

Lower of cost or market in accordance with the facts. Special reliefs give deductions for increase in value due to inflation; this makes the end result equal to LIFO accounting.

Italy

Tax system lays down a method consistent with LIFO. Companies may elect to use another method. There must be consistency between books and tax return for LIFO to be accepted.

Japan

Acceptable methods of inventory valuation include LIFO, FIFO, weighted average, moving average, straight average, most recent purchase, retail and lower of cost or market. Conformity between book and tax reporting is required.

Luxembourg

Lower of actual cost or market. LIFO and FIFO not acceptable for tax purposes unless it can be shown that it conforms with the facts.

The Netherlands

In general, inventories stated at lower cost or market. Cost may be determined on basis of FIFO, LIFO, base stock or average cost.

New Zealand

Lower of cost or market. LIFO is not permitted.

Norway

Lower of cost or market. FIFO is also acceptable for tax purposes, but not LIFO. Conformity between book and tax reporting is required.

Spain

In the absence of an identification of the various purchases, LIFO, FIFO or average cost methods are accepted. Conformity between books and tax returns is required.

Sweden

Lower of acquisition or replacement cost. Acquisition cost determined by FIFO. LIFO is not permitted. Conformity between books and tax returns is required. Appropriations may be made to an inventory reserve.

Switzerland

Lower of cost or market. A reserve for unexpected decreases in value can be set up and deducted from income.

United Kingdom

Inventories stated at lower of cost or market. LIFO not permitted. Special tax deduction is available for the effect of monetary inflation on inventories.

United States

Inventories generally stated at lower of cost or market. LIFO, if used for book, can be elected for tax purposes.

THE EFFECT OF THE 3% INVENTORY ALLOWANCE

APPENDIX II - 3

APPENDIX 2

TOTAL ALL INDUSTRIES

Companies having \$10 million or more total assets

	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>
1. Opening inventories (\$000,000)	26,175*	27,915	29,973,	36,933
2. 3% of opening inventories (\$000,000)	785	837	899	1,108
3. Income before provision for income				
Tax (\$000,000)	13,168	15,885	23,197	25,771
4. Adjusted income before tax (\$000,000)	12,383	15,048	22,298	24,663
5. Tax rate on stated income	30.9%	27.7%	27.7%	26.5%
6. Taxes payable on adjustable income (\$000,000)	3,826	4,168	6,177	7,029
7. Inventory profits (\$000,000)	1,832	1,787	3,087	3,878
8. Inventory adjustment allowances as a % of				
inventory profits	42.8%	46.8%	29.1%	28.6%

*At end First Quarter, 1977

WHOLESALE INDUSTRY
Companies having \$10 million or more total assets

	Food				Lumber & Building Products				Other Wholesale			
	1977	1978	1979	1980	1977	1978	1979	1980	1977	1978	1979	1980
1. Opening inventories (\$000,000)	366*	450	504	606	292*	272	294	307	1,338*	1,355	1,599	2,061
2. 3% of opening inventories (\$000,000)	11	14	15	19	9	8	9	9	40	41	29	62
3. Income before provision for income Tax (\$000,000)	80	112	141	156	51	81	103	73	198	310	497	483
4. Adjusted income before tax (\$000,000)	69	98	126	138	42	73	94	64	158	269	449	421
5. Tax rate on stated income	30.0%	34.8%	33.3%	20.2%	33.3%	29.6%	29.1%	24.7%	47.5%	39.0%	42.5%	42.0%
6. Taxes payable on adjustable income (\$000,000)	21	34	42	39	14	22	27	16	75	105	191	177
7. Inventory profits (\$000,000)	26	29	52	64	20	17	30	32	94	87	165	216
8. Inventory adjustment allowances as a % of inventory profits	42.3%	48.3%	28.8%	28.1%	45.0%	47.1%	30.0%	28.1%	42.6%	47.1%	29.1%	28.7%

*At end First Quarter, 1977

RETAIL INDUSTRY
Companies having \$10 million or more total assets

	Food				Department Stores				Other Retail			
	1977	1978	1979	1980	1977	1978	1979	1980	1977	1978	1979	1980
1. Opening inventories (\$000,000)	544*	636	694	814	1,516*	1,826	1,968	2,476	513*	618	682	919
2. 3% of opening inventories (\$000,000)	16	19	21	24	45	55	59	74	15	19	20	28
3. Income before provision for income Tax (\$000,000)	142	172	206	264	211	242	361	369	159	218	246	248
4. Adjusted income before tax (\$000,000)	126	153	185	240	166	187	302	295	144	218	246	248
5. Tax rate on stated income	41.5%	39.0%	38.3%	33.3%	36.5%	19.4%	26.0%	29.3%	46.5%	43.1%	45.1%	42.7%
6. Taxes payable on adjustable income (\$000,000)	52	60	71	80	61	36	79	86	67	86	102	94
7. Inventory profits (\$000,000)	38	41	71	85	106	117	203	260	36	40	70	96
8. Inventory adjustment allowances as a % of inventory profits	42.1%	46.3%	29.6%	28.2%	42.5%	47.0%	29.1%	28.5%	41.7%	47.5%	28.6%	29.1%

*At end First Quarter, 1977

APPENDIX III

**THE ECONOMIC IMPACT OF MOVING TO 75% OF WORLD PRICES
BY 1985***

A simulation exploring the macro-economic impacts of the crude petroleum oil pricing schedule designed by the Distributive Trades Consultative Committee was performed using the Economic Council of Canada's econometric model, CANDIDE 2.0. The committee was particularly interested in the impact of the pricing policy on various items of consumer expenditure, both in terms of price and of spending.

Assumptions

- Crude Petroleum

The basic premise underlying the assumptions is that the wellhead price of crude petroleum should reach 75 percent of the F.O.B. international price by 1985 and be tied to the world price at that ratio for the remainder of the projection period to 1990. In order to reach the 75 percent mark by 1985, it was assumed that the wellhead price would further increase by \$2.00 per barrel on November 1, 1981, thereby averaging \$18.85 for the year, and would then increase by \$7.17 per year until 1985 (\$7.15 in 1985) at which time it would reach \$47.24, 75 percent of the world price of \$62.99.

The prices for new oil (tertiary recovery) and for tar sands oil are assumed to increase from their respective levels of \$30.00 and \$38.00 in 1981 at the real rate of increase in the international price - 2.0 percent - plus a projected increase in the Consumer Price Index. The international price (F.O.B.) is \$42.41 in Canadian dollars in 1981 and increases by 2 percent real growth plus the rate of inflation in the U.S. Wholesale Price in the November 1980 Wharton Base Case. In 1990, it reaches \$97.10.

It was assumed that with the resolution of the pricing impasse, the two large oil sands projects would resume operations at full speed, with the Alsands plant reaching full production of 137,000 barrels per day by 1989 after coming onstream in 1987. The disbanded Cold Lake in situ project was assumed to reach full construction activity after only an 18 month period to reassemble its staff, and to come onstream in 1987 and to reach full two train production level of 140,000 barrels a day by 1991, beyond the projection period. A third project, involving Petro-Canada, was assumed to come onstream in 1988 and to reach full 140,000 barrel per day production level by 1990.

Because of the more generous wellhead pricing provisions, it was assumed that considerable progress would be made with enhanced recovery production techniques, and that by 1990, 100,000 barrels a day would be forthcoming, adding to the present estimates of conventional production available taken from Energy, Mines and Resources. It was also assumed that, with an oil pricing agreement, Alberta crude petroleum conventional production would be returned to pre-cutback levels in 1982.

Canadian demand for crude petroleum was assumed to decline .35 percent per annum over the 1981-1990 period, with only minimal exports, mostly of heavy crude, (with additional exports under the swap arrangement) allowed. Imports of crude petroleum are a residual, that is, total demand is subtracted from total available domestic supply to determine the required level of imports.

- Natural Gas

The domestic and wellhead prices for natural gas have remained at the values in the base case which are close to those suggested in the National Energy Program. The export price of gas has been tied to the movements in the international price of crude petroleum. The rationale behind the gas pricing pattern is one of providing an incentive to substitute to natural gas from crude petroleum. In terms of b.t.u. equivalency, the natural gas price falls from 85 percent in 1980 to 69 percent in 1990.

The supply estimates and domestic and export demand for natural gas are taken from the November 1979 "Gas Report" issued by the National Energy Board. Total primary demand for natural gas, including that scheduled for expanded markets in Eastern Canada, is estimated in the NEB report to increase at 6.6 percent per annum over the 1980-90 period. Consumer demand for gas has been set to increase in the simulation at an annual average of 5.5 percent over the decade.

Table 1 presents the various price estimates for crude petroleum and natural gas.

The Results of the Simulation

The assumptions were incorporated into the Economic Council of Canada's Spring Reassessment Base Case described in detail in "The Medium-term Outlook: Spring 1981 Reassessment" published in early June 1981.

As a result of the shift to higher wellhead prices in the early part of the decade, the rate of inflation is considerably higher in the impact solution than in the base case from 1981 through 1985 (see Table 2). However, on average, throughout the period the rate of inflation in the shock is 10.5 percent versus 10.4 in the base. Over the decade, the level of the consumer price index is on average 2.1

percent higher than in the base. What has happened is that inflation throughout the decade is not much higher, however, it has shifted forward to the first half.

In terms of real growth we see a slightly different story. The higher inflation in the economy impacts all sectors of the system resulting in a cumulative loss in real gross national product throughout the period of \$9.7 billion¹, despite an exogenous increase in crude petroleum and natural gas mining investment of 1.9 billion 1971 dollars throughout the period. The loss is centered in the 1982-86 period, and by 1990 real GNP in the shocked solution is just 370 million \$1971 lower than the base case. By the end of the period the effects of the higher inflation have taken their toll and the economy is on the road to recovery. It is interesting to note that this redistribution of GNP results in similar average rates of growth over the period.

Total nominal investment as a percentage of gross national product remains almost the same in both solutions. The additional energy investment has been offset by a reduction in investment in other sectors of the economy. It is in the area of the government balances and the current account balance where the greatest impacts can be seen.

The federal government moves into a surplus position in 1985, rather than in 1986 in the base case, and by the end of the decade this surplus is \$1.6 billion higher. This arises from a combination of factors including lower debt servicing charges on a stock of debt that is reduced \$9.7 billion by the end of the period and some increase in net energy revenues. These factors have been offset to some degree by reduced corporate taxation revenues from the reduced activity in the system.

The provincial governments' surplus increases quite dramatically as a result of increased royalty revenues accruing to the energy-producing provinces. In the assumptions for the impact, solution, we have assumed no change from the base case in the provincial royalty structure which, in Alberta, is designed to capture close to 50 percent of any incremental revenues on conventional oil production. The provinces also benefit from reduced debt servicing costs on a debt stock which is reduced by some \$14 billion by 1990.

Because of the additional crude petroleum production both from early production from tar sands and from the additional enhanced recovery production, the level of crude petroleum imported into Canada has been reduced. By 1990, imports supply only 17 percent of Canadian requirements compared to 22 percent in the base case, and are 32 billion barrels lower in 1990. As a result of the lower imports there is an improvement in the current account balance, measured as a percentage of GNP in Table 2. By 1990 the current account balance has improved by \$3.8 billion, a fairly substantial improvement.

¹ Real GNP in the shock is 169.4 billion 1971 dollars in 1990.

Table 3 indicates the impacts of the Consultative Committee's pricing strategy on the various consumer expenditure items detailed in CANDIDE Model 2.0. Compared to the Spring Reassessment Base Case, the shocked solution results in some reduction in consumer spending, especially in durable goods, and in an average increase over the 10 year period of 1.7 percent in the consumer expenditure deflator.

While the suggested pricing pattern has higher inflationary impacts in much of the decade and results in some reduction in real growth, it has also resulted in improved deficit positions both for the federal government and on our international accounts. Furthermore, the Canadian economy is a good step closer to self sufficiency in 1990 than it is in the Council's Spring Reassessment.

Table 1

Energy Sub-Committee Energy Pricing Scenario

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Crude Petroleum Prices (per barrel)										
International Price (\$ Cdn. F.O.B.)	42.41	47.50	52.54	57.63	62.99	68.79	74.98	81.80	89.16	97.10
International Price at Montreal (\$ Cdn.)	44.06	49.20	54.28	59.43	64.85	70.70	76.95	83.83	91.25	99.25
Domestic Blended Price at Toronto City Gate	26.11	34.33	41.85	48.98	55.92	61.14	66.63	72.91	79.13	86.52
% of International FOB Price	61.6	72.3	79.7	85.0	88.8	88.9	88.9	88.9	88.8	89.10
Domestic Wellhead Price - Conventional Oil	18.58	25.75	32.92	40.09	47.24	51.59	56.23	61.35	66.87	72.82
% of International FOB Price	43.8	54.2	62.7	69.6	75.0	75.0	75.0	75.0	75.0	75.0
- New Oil	30.00	33.42	37.06	40.40	45.01	49.60	54.90	60.45	66.62	73.48
- Tar Sands	38.00	42.33	46.95	52.06	58.00	63.91	70.75	77.90	85.85	94.69
Natural Gas Prices (Per MCF)										
Domestic Price at Toronto City Gate	2.98	3.40	3.85	4.41	5.09	6.02	7.05	8.08	9.11	10.24
Domestic Wellhead Price	1.64	1.75	1.93	2.30	2.79	3.50	4.29	5.04	5.74	6.51
Export Price at the Field	6.03	6.71	7.34	8.13	8.85	9.74	10.68	11.73	12.86	14.08

Table 2

Comparison of Energy Sub-committee Pricing Schedule Impact and Spring Reassessment Base Case

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Real GNE (percent change)										
Energy Sub-committee Impact	2.7	2.8	3.5	3.0	2.2	3.0	2.5	2.2	2.9	-2.4
Spring Reassessment	2.9	3.0	4.0	3.0	2.4	2.6	2.9	1.7	2.4	2.4
Consumer Price Index (percent change)										
Energy Sub-committee Impact	11.9	13.3	12.5	11.2	11.2	9.9	9.5	9.0	8.4	8.2
Spring Reassessment	11.4	11.9	11.5	10.5	10.8	10.3	10.4	9.8	9.3	8.6
Unemployment Rate (percent)										
Energy Sub-committee Impact	7.2	6.4	5.6	5.3	5.4	5.6	5.8	6.3	6.4	6.6
Spring Reassessment	7.2	6.5	5.5	5.3	5.4	5.6	5.6	6.2	6.5	6.8
Federal Deficit (billions of dollars)										
Energy Sub-committee Impact	-7.3	-5.5	-3.4	-1.1	.1	1.4	2.3	3.1	5.2	7.1
Spring Reassessment	-8.1	-7.9	-4.0	-1.4	-.1	.5	1.9	2.1	3.6	5.5
Provincial Surplus (billions of dollars)										
Energy Sub-committee Impact	2.60	4.6	4.8	5.8	6.6	8.1	9.1	9.8	12.1	14.0
Spring Reassessment	2.7	3.6	3.4	4.3	5.0	6.4	7.7	7.7	9.1	11.2
Current Account Balance (% of GNE)										
Energy Sub-committee Impact	-0.7	-0.7	-1.2	-1.8	-2.1	-2.4	-2.4	-2.0	-1.8	-1.6
Spring Reassessment	-0.8	-1.4	-1.4	-2.0	-2.4	-2.7	-3.0	-2.5	-2.3	-1.9
Investment as a Percentage of GNE										
Energy Sub-committee Impact	23.5	23.5	24.4	25.0	25.2	25.6	25.4	24.9	24.8	24.7
Spring Reassessment	23.5	23.7	24.4	25.1	25.4	25.6	25.8	25.2	24.9	24.5

Source: Economic Council of Canada, August 1980

Table 3

**Difference in Impact Between the Pricing
Schedule of the Distributive Trades Consultative Committee and That
Of the National Energy Program**

	<u>10 Year Average Impact on Spending</u>	<u>10 Year Average Impact on Price</u>
Total Consumer Expenditure	-0.90	1.67
Durable Goods	-1.27	0.69
Recreation Equipment	-0.75	0.91
Furniture & Carpets	-1.80	1.00
Household Appliances	-1.91	0.95
New and Used Autos	-1.89	0.38
New Autos	-1.85	0.37
Used Autos	-2.09	0.39
Repairs & Parts	-0.68	0.84
Semi-durable Goods	-0.46	1.03
Men's and Boy's Clothing	-0.22	1.05
Women's, Girl's & Infant's Wear	-0.58	1.37
Footwear & Repair	-0.31	0.99
Books, Newspapers & Magazines	1.05	0.69
Semi-durable Household Furnishings	-0.78	0.76
Jewellery, Watches & Repair	-0.72	0.82
Non-durable Goods	-1.00	2.94
Food & Non-alcoholic Beverages	-0.13	1.13
Alcoholic Beverages	-0.91	0.76
Tobacco	0.25	0.61
Non-durable Household Supplies	-0.26	0.34
Drugs & Sundries	-1.17	0.97
Toilet Articles & Cosmetics	-1.05	1.17
Electricity	-0.56	0.96
Gas	6.28	0.00
Other Fuels	6.28	15.86
Gasoline, Oil & Grease	-14.44	13.81
Services	-0.64	1.24
Travel Expenditures	-1.94	0.00
Travel Receipts	-1.65	4.18
Recreational Services	-1.28	1.23
Educational & Cultural Services	0.84	1.29
Laundry & Dry Cleaning	0.00	0.97
Domestic Services	-0.26	1.91
Other Household Services	-1.89	0.91
Medical Care	-0.04	0.99
Doctors' Fees	-1.40	3.36
Dentists' Fees	-0.52	0.93
Other Practitioners	-0.75	0.58
Hospital Care	-0.00	0.74

Table 3 (Cont'd)

	<u>10 Year Average Impact on Spending</u>	<u>10 Year Average Impact on Price</u>
Services (Cont'd)		
Other Medical Care Expenses	-2.75	0.91
Personal Care	-1.08	0.98
Expenditures on Restaurants, Hotels	-0.59	0.96
Financial, Legal & Other Services	-0.95	1.45
Operating Expenses of Non-profit Organ.	-0.77	1.74
Gross Imputed Rent	-0.22	1.46
Gross Rent Paid	-0.21	1.11
Other Lodging	-0.65	1.03
Other Auto Related Services	-0.99	1.12
Purchased Transportation	-1.59	1.60
Addendum:		
Doctors, Private & Government	-1.40	1.22
Medicare	-1.40	1.03
Hospital, Private & Government	-0.00	0.86
Hospital Care, etc.	-0.00	0.74
Permanent Income Proxy	-0.93	1.67
Consumer Price Index	NA	2.10

Source: Economic Council of Canada, August, 1981.

APPENDIX IV

COMPETITION LEGISLATION

In view of the Committee, the proposals for amending the Combines Investigation Act introduced by the Honourable Andre Ouellet, the Minister of Consumer and Corporate Affairs, in April 1981, will retard rather than enhance the competitive climate within Canada.

Particularly do they appear unsuited to the distributive trades, characterised as they are by competition within local markets, many of which are small. It is the strong recommendation of the task force that the direction contemplated be changed in favour of one which deals with the misuse of a dominant position in case of actual behaviour, or the acquisition of a dominant position in the case of mergers and acquisitions.

The more significant of the Committee's views in relation to the proposals can be summarized as follows:

- 1) The structuralist approach adopted in the proposals is the subject of spirited controversy in economic circles everywhere. Whatever its application to large markets such as those of the U.S.A., it would appear to have little relevance to the small, sparsely populated market of Canada. Empirical experience including that in the retail trade, shows that the vigor of competition is not determined by the number of entrants. In fact, in many retail trades, the most vigorous competition only develops after a sector becomes somewhat concentrated;
- 2) The question of the definition of a "market" is particularly important for the distributive trades. Decisions have to be made in relation to whether a "market" is in fact a local trading area, and also whether levels of competition should be determined by commodity rather than by store type. In the view of the Committee, a trading area is the competitive market for distribution trade purposes, and competition has to be judged by commodity or merchandise grouping rather than by store type. This latter consideration is particularly relevant in an era of "scrambled merchandising";
- 3) A decision on the forum in which competition cases are dealt with will likely be substantially influenced by the nature of the process. Questions of jurisdiction may also influence whether a civil or criminal law approach is taken. All things being equal, the Committee would prefer to see the Federal Court used as the forum, and all except conspiracy cases dealt with by civil rather than criminal law. Even if a court procedure is used, however, it is felt that there should be an ultimate appeal to a political authority to deal with cases where there are some overriding considerations which are unlikely to be capable of resolution in a court. Otherwise, court procedures do provide the facility of

appeal on routine matters and a civil jurisdiction avoids the unnecessary stigma which the criminal jurisdiction casts over the present procedures. It is noted that in any event, the civil remedies may be substantially more onerous than the fines which flow from the successful criminal prosecution.

- 4) If the type of procedure eventually decided upon raises any constitutional issues (as it is likely to do) it is the Committee's recommendation that constitutional doubts be resolved through the Federal Government obtaining the appropriate rulings from the Supreme Court on matters relating to constitutionality.
- 5) In place of the use of a pre-designated market share to test whether a horizontal merger or acquisition should be permitted, or permitted with suitable strictures, we believe attention should be focussed on the state of competition which will exist after the merger. Because of retailers' problem with "market" and "market share" we do not think it is realistic to establish any arbitrary figure at which a retailer would be deemed to have a "dominant market position". All over Canada there will be thousands of establishments, independents and branches of multi-unit merchants, who would be deemed to be in a "dominant market position" in a commodity or commodities within their trading areas just because they achieved some share of market which had been laid out in the legislation.
- 6) The concept of joint monopolization as a status -- without reference to behaviour which is shown to be harmful -- is an artificial concept which we suggest should not be introduced in Canada. Four firm market shares ranging from 40-70% are common phenomena in Canadian retailing markets demonstrating healthy competition.
- 7) We believe that many of the "anti-competitive practices" listed in the discussion paper may be pro- rather than anti-competitive. We refer specifically to such listed practices as "selective price cutting", "narrowing by a vertically integrated supplier of a margin on which an unintegrated competitor is operating", "the use of fighting brands", "pre-emptive acquisition of scarce facilities or resources", "market saturating advertising". All of these practices, in certain circumstances can, in fact, indicate strongly pro-competitive action.
- 8) We take strong issue with the proposal to introduce a conscious parallelism concept into the conspiracy law. We allude to the findings of the Royal Commission on Corporate Concentration on this subject. We also point out that there are some negotiated restrictions on business which have no negative effects on third parties -- the vendor of a business agreeing with a purchaser that the vendor will not re-enter that business within a given

geographical area for a specified length of time, or one or more tenants in a shopping centre and the landlord agreeing that the landlord will not let space to more than a pre-determined number of similar businesses within that centre. We suggest that a per se rule in this context is not apt. The action complained of should be required to be accompanied by a consequence which causes a third party injury.

- 9) We believe that the exemptions listed in the present section 32(2), of the Act, should be retained. Such useful activities as refining product for standards, introducing accepted size and weight norms, establishing packaging levels or quality, have often been undertaken at the request, and with the support, of Government. It is argued that no protection is needed if such procedures are not in themselves anti-competitive. However the mere removal of the section is likely to induce suspicion in relation to activities which can be legitimately and safely carried on under its protection. We recommend retention of the status quo.
- 10) We concur with the proposal that suppliers be required not to refuse supply to customers simply because such customers wish to take delivery of the product in some other location where the suppliers are offering the product to other customers.

The members of the Committee have had an opportunity to review the submission to the Minister of Consumer and Corporate Affairs on this subject prepared by Retail Council of Canada, and dated June, 29, 1981. The thrust of that submission is broadly acceptable to the members of the Consultative Committee.

APPENDIX V

DISTRIBUTIVE TRADES -- STATISTICAL NEEDS

Management decisions within the distributive trades, the businesses which supply and service them, and in the public sector, are being severely handicapped because of the paucity, poor quality and lack of timeliness of statistics reflecting the fast changing patterns of distribution activity.

Particularly serious has been the cancellation of the planned 1981 census of merchandising and the threat that this census will not now be undertaken in 1982, in a streamlined form, as originally seemed likely.

In addition to the periodic merchandising census which is the keystone of all distributive trade information, a number of other studies deserve to be updated, expedited, and in some cases, instituted. All of these subjects were addressed in a paper prepared on behalf of a task force of information users directed to the Chief Statistician, and dated February 17, 1978. The views expressed in that paper are still completely relevant, and the detailed recommendations contained in it are proposed for adoption.

Merchandising census data are considered vital because of the following factors:

- 1) Essentiality -- accurate benchmark figures which only the census can supply are indispensable. No individual organisation can obtain an exact count of businesses, sales and revenue, locations, breakdown by kind of business, and matching employment data;
- 2) Comprehensiveness -- no other source of data provides detailed figures for all areas and for all types of merchandising enterprises;
- 3) Reliability -- the method of collecting and analysing census data eliminates sampling bias;
- 4) Continuity and comparability -- the consistency of methods used in collecting and reporting census data make the information extremely valuable in demonstrating longer term trends;
- 5) Availability -- the census data are available to all users at low cost.

The private sector makes use of the data in determining the most economic location of stores, warehouses, shopping centres and manufacturing facilities. It needs it to form an understanding of

shifting trends and shopping patterns, and structural changes in distribution. It provides a measure of market potential for given products. It permits the allocation of outlets, sales staff and advertising to markets in proportion to their significance. The federal, provincial and municipal governments are also users of the information in the formulation of economic policy and sector related programs. Provinces and municipalities need it for urban planning and for a variety of subsidiary uses. Other sectors of the economy, including academic institutions, publishers, private and public research organizations, utilities and transportation companies, consultants, are either primary or intermediary users of the information. These users plan an important role in improving the efficiency of the economy as a whole.

It is instructive that the United States, after eliminating the census of business, manufacturers and mining in 1953, felt obliged to reinstate the economic census in 1954 in a truncated form, and has since consistently upgraded the extent and quality of the information derived from its economic censuses.

The February, 1978 paper recommends a number of other improvements in information reporting including:

(i) News Surveys

Weekly reporting of department and chain store sales by major "kind of business" categories;

Annual financial operating ratios covering individual sub-sectors over a three year timeframe;

Bi-annual reports of shopping centre developments to track major structural changes within retailing;

Bi-annual reports or voluntary group stores to track major structural changes in retailing.

(ii) Expansion and Improvement of Existing Programmes

Monthly retail trade estimates: expanded to encompass major census metropolitan areas such as Calgary, Edmonton, Hamilton, Ottawa, Quebec City and Halifax;

Merchandising inventories (monthly or quarterly): to include a breakdown of independent retail stores by dollar level, by "kind of business";

The labour force: include breakdown of commerce into sectors or sub-sectors;

Industrial corporations: include breakdown of retail and wholesale trades into sub-sectors, using same basis as employment earnings and hours.

In the United States the breakdown of communication between statistical users in the private sector and the planners of the U.S. government's business statistical services which was manifested in the precipitate abandonment of the 1953 census and the agitated efforts to restore the damage in the mid- and later 50's resulted in the formation of a "Statistical Users Conference". This body was designed to provide the U.S. Government with a sensitive reading of the statistical needs of the commercial community. There is a parallel need for such a body in Canada. It is recommended that such a body at least be formed for the distribution trades or, if an overall advisory body is contemplated that there be a strong distribution sector created within it.

With Statistics Canada currently reviewing its priorities and function, establishment of such an advisory council should be regarded as a high priority issue.

In framing all these recommendations the Committee is sensitive to the desirability of minimizing the paper burden on businesses. The census and the surveys which have been suggested can be so undertaken that they are economical of time and effort in the private sector. In any event, the results should recompense the providers of the information many times over for the effort expended on their completion.

THE DISTRIBUTIVE TRADES:

WHOLESALE AND RETAIL INDUSTRIES OF THE 1980s

SUMMARY

The distributive trade sector is large, diverse, important, and neglected. There are over 230,000 wholesale, retail, and trading house establishments in Canada, compared with about 50,000 manufacturing establishments. Over 12 per cent of the Real Domestic Product (1977) stems from the activities of the distributive trades compared with 9.6 per cent from Transportation, Storage, and Communication — another important service industry sector. Within the goods producing sector,* Construction accounts for 6.5 per cent; Transportation Equipment for 2.8 per cent; and Textile, Knitting and Clothing combined for 1.6 per cent.

The distributive trades employ nearly 8 times as many people as Textile, Knitting and Clothing, and over 9 times as many as the Transportation Equipment industries. Nearly one in every five employed Canadians (17 per cent) works in the distribution system and, unlike the concentration of manufacturing employment in specific regions and locations, employment in the distributive trades takes place in small as well as large communities in every part of Canada. Yet, in spite of the size and extent of the sector, government lacks information about it and may seem to industry to be indifferent to the problems and changes in the distributive trades.

* The industries that are included in the goods producing sector are listed in Table VII.

THE DISTRIBUTIVE TRADES IN PERSPECTIVE

The distribution service sector is defined as the wholesale and retail trades.* It is composed of all firms that distribute goods from manufacturers and/or primary producers in the market channels supplying consumers in Canada and foreign markets. The sector is composed of a wide assortment of wholesale and retail entities with orientations towards particular types of markets. Thus, each individual firm makes decisions based on the types and range of products carried, its size, location, market philosophy, and its perception of consumer demand and service requirements. Even the largest corporate entities are specialized along commodity lines and regions, although there is a growing trend towards generalized product mix by the larger companies.

Characteristics of the Distributive Trades

In its simplest terms, the distributive trades provide the market channels through which production is transformed into consumption. Their function ensures that consumers obtain possession of the products they want at the time and place best suited to their needs. How the various activities are carried out varies by commodity(s), distance from supply, size of all firms interacting and/or competing, philosophies of all firms related to their perception of the market place, and the firm's social and economic environment.

* For purposes of this paper, wholesale is inclusive of wholesalers, brokers, jobber, commission agents and the other forms of businesses which interact between manufacturers and retailer.

Firms vary according to consumers' perception of quality and price, e.g., discount stores through to very expensive retail outlets. As a group, retailers cover all possible consumer expenditure levels, and within any locale there is a very definite stratification of retail outlets. Firms tend to stay within their strata because to do otherwise would necessitate changes in image, consumers, suppliers, etc. The chief exception are large chains; they sometimes create more than one image aimed at different consumer markets. This combination of factors means that there are literally hundreds of different marketing channels, all of which are "optimum" only for particular firms at particular times in their business evolution.

Some retailers are broadening their market appeal by selling services such as insurance or travel. While this type of activity is found mainly outside the retail sector, it is seen by retailers as a move towards "one-stop" shopping.

Underlying all aspects concerning the behaviour of the distributive trades are the concepts of demand translation and service. A retailer's survival depends on his ability to perceive consumer demand and predict where it is trending. This anticipated demand is then communicated back to the productive system, largely through buying patterns but increasingly by product specification.

Competitive Environment

A fuller understanding of the sector's behavioural patterns and the possibilities for partnership can be obtained by looking at the

environment in which a firm operates. In the case of the distributive trades the environment fluctuates, but tends to be intensely competitive.

For wholesalers, competition is derived from other types of business as much as from firms with an exclusive wholesale function. They stay in business as long as they ensure that (i) the retailer receives the right quantity of a product at the right price, time and place, and (ii) the manufacturer sells his product according to his production schedule. The wholesaler must constantly maintain and improve his efficiency to guard against the tendency of both retailers and manufacturers to assume part or all of the wholesaler function in order to "eliminate the middleman."

A wholesaler remains in business by specializing in the type of goods he assembles, stores and delivers. Consequently, types of wholesalers vary: general-merchandise (carrying a broad assortment of unrelated products), general line (completely supplying one line of items), and specialty (handling a limited number of items). Another type of wholesaler is the full-service wholesaler. These businesses not only supply products, but offer a full range of services. Wholesalers stay in business because they perform market functions at a lower cost than manufacturers or retailers. They flourish by providing small and medium-sized manufacturers and retailers with such services as buying for customers and selling for suppliers, assembly, delivery, warehousing, credit, assumption of risk and to an increasing extent advise on the various "how-to" aspects of distribution.

Wholesalers are maintaining their competitive edge by providing an economical transfer of goods and by including a greater and greater degree of service in their transaction price. Wholesalers generally exist as independent businesses, but can be an arm of a larger corporation (either retailer or manufacturer), or can belong to groups of manufacturers or retailers who have banded together into cooperatives or voluntary associations.

Competition in retailing occurs in a number of different ways. Entry into retailing is relatively easy. Capital costs are low, and inventory is obtainable on credit. Superficially, even the skills required appear to be within the capability of most people. In addition to entry being relatively easy, opportunities for entry are also perceived to exist because of new products, concepts and locations. Thus retailing and, by extension, parts of the service industry have become the most accessible opportunity for individuals who want to establish their own business.

Competition also occurs between firms already in the industry. All retailers are constantly expanding or reducing their product mix depending on the economic climate and changes in demand and supply. Some stores, e.g., food stores, are trying to capture a market share in a greater range of commodities by adding lines not normally associated with the store, other stores are specializing in a narrower product mix in order to capture a larger share of a smaller market base.

Long term strategy is based on anticipated population changes and economic conditions. All large companies have five to ten year plans for expansion into new markets and locations and the competition for future choice locations is intense.

Concentration

The wholesale industry is fragmented -- no individual firm holds more than 2 per cent of the market, even though some general merchandise wholesalers are extremely large in terms of dollar sales (Table I).

Within the general merchandise category, however, there has been some concentration. An example is hardware lines, where stock-keeping is costly. A number of technologically sophisticated wholesalers have developed in this area and one firm has captured 10 per cent of the market.* This is not an unusual situation in hardline goods, where manufacturers are relinquishing the wholesale function.

In food, the 10 largest wholesale firms accounted for \$4.8* billion of a total market of \$11.6 billion (1978).** Most of the large firms in this field are closely identified with, and provide a number of services and price advantages to, the independent segment of the retail grocery market.

* Dun and Bradstreet, Annual Reports, and D.S.B. estimates

** Statistics Canada, Catalogue No. 63-008.

TABLE I
PERCENT DISTRIBUTION OF NUMBER OF ESTABLISHMENTS FOR
 WHOLESALE AND RETAIL TRADE BY SALES GROUP, 1978

							TOTAL	
	UP TO	100\$T	500\$T	1\$M	5\$M	10\$M		
	99.9\$T	499.9\$T	999.9\$T	4.9\$M	9.9\$M	OVER	N/R	
WHOLESALE TRADE								
- TOTAL	16.1	27.6	11.2	15.5	2.3	2.0	25.2	100
Food	11.3	23.9	12.5	20.3	4.0	4.2	23.8	100
Drugs and								
Sundries	15.2	22.2	9.6	14.4	3.6	3.6	31.6	100
General								
Merchandise	14.7	25.4	10.5	15.0	2.5	1.5	30.2	100
Other*	16.8	28.4	11.2	15.1	2.1	1.8	24.6	100
RETAIL TRADE								
- TOTAL	34.3	34.1	5.6	4.3	0.5	0.4	20.9	100
Food	33.3	32.2	5.0	3.3	0.2	0.2	25.8	100
Drugs etc.	10.0	51.6	14.1	7.7	0.4	0.3	16.0	100
General								
Merchandise	38.7	33.4	5.4	3.4	0.3	0.2	18.5	100
Automotive &								
Alcohol	27.6	36.9	6.3	7.5	1.4	0.8	19.4	100

Source: Dun and Bradstreet. (IST). June, 1979.

The wholesale pharmaceutical industry is a little more concentrated with nine companies accounting for 51 per cent of the market in 1978.* Again, these wholesalers support the independent retailer. As well, there are many small distributors of specialized drug products and most pharmaceutical manufacturers have a direct selling arm to retailers.

There is a greater degree of concentration at the retail level of the general merchandise area: one corporate entity has 11 per cent of the market. In Department store sales, the Hudson's Bay Company, Sears and Eatons have a combined market share of more than 75 per cent.** Competition is beginning to mount from specialty chain retailers who compete directly with department stores on a commodity basis.

Gross sales of the five largest grocery chains were approximately \$8.4 billion in fiscal year 1978.* This total reflects consolidated sales of the chains and their subsidiaries and so cannot be directly compared to total sales of \$16.3 billion by supermarkets and grocery stores.*** It is estimated that the chains held 60 per cent of the market in 1978, down slightly from 1977.**** Competition is growing from convenience store chains and specialty stores.

* Dun and Bradstreet, Annual Reports, and D.S.B. estimates

* Individual company annual reports and Statistics Canada, Department Store Sales and Stocks, Catalogue 63-002.

*** Statistics Canada, Catalogue No. 63-005.

**** Maclean-Hunter Research Bureau, based on Statistics Canada Data.

The market share of chain stores in drug retailing is estimated at 49.5 per cent (1979), with franchise groups accounting for 56.8 per cent of this total.*

Regional Distribution

Regional shares of sales are, of course, closely tied to the size, density and income of the population. Large urban centres have more retail outlets and a greater sales volume than their population would suggest. The most densely populated provinces, Ontario and Quebec, account for over 60 per cent of retail sales, but Ontario's share has declined during the last decade. During the same period Alberta's share has increased steadily (Table II). The growth rate of retail sales is variable, both nationally and regionally, with Ontario and Manitoba having the lowest regional growth rates in 1979 (Table III).

PAST PERFORMANCE

The wholesale and retail trades, which together make up the distribution services sector, constitute a large and diverse segment of the Canadian economy. In 1979, the sector comprised some 230,000 firms (Table IV), employed more than 1.8 million persons (Table V) and reported sales of over \$160 billion (Table VI). Its contribution to the gross domestic product was slightly over 11 per cent (Table VII).

* Estimated by Distribution Services Branch.

TABLE II
PERCENT DISTRIBUTION OF ANNUAL SALES OF RETAIL TRADE
FOR CANADA BY REGION, 1960-1979

	ANNUAL AVERAGE (%)			
	1960-1964	1965-1969	1970-1974	1975-1979
CANADA	100.0	100.0	100.0	100.0
ATLANTIC PROVINCES	8.4	8.2	8.2	8.1
QUEBEC	25.6	25.9	25.2	25.2
ONTARIO	38.2	38.2	38.2	36.6
MANITOBA	4.7	4.4	4.4	4.1
SASKATCHEWAN	4.8	4.4	3.9	4.3
ALBERTA	8.0	7.9	8.1	9.6
*PRAIRIE PROVINCES	17.5	16.6	16.4	17.9
B.C., YUKON & NWT	10.3	11.1	12.0	12.0

	1974	1975	1976	1977	1978	1979
CANADA	100.0	100.0	100.0	100.0	100.0	100.0
ATLANTIC PROVINCES	8.1	8.1	8.1	8.0	8.2	8.2
QUEBEC	25.4	25.3	25.3	25.2	25.0	25.5
ONTARIO	37.0	37.3	36.8	36.8	36.6	35.7
MANITOBA	4.4	4.3	4.2	4.1	4.0	3.8
SASKATCHEWAN	4.2	4.4	4.4	4.2	4.2	4.2
ALBERTA	8.3	8.9	9.2	9.6	9.9	10.5
*PRAIRIE PROVINCES	17.0	17.5	17.9	17.9	18.0	18.4
B.C., YUKON & NWT	12.4	11.8	11.9	12.1	12.2	12.2

SOURCE: STATISTICS CANADA. RETAIL TRADE. CATALOGUE 63-005.
(CANSIM 2431; 78; 2300), 2 JULY 1980.

TABLE III
PERCENT CHANGE IN ANNUAL SALES OF RETAIL TRADE
FOR CANADA BY REGION, 1960-1979

	<u>ANNUAL AVERAGE GROWTH RATES</u> (%)			
	1960-1964	1965-1969	1970-1974	1975-1979
CANADA	4.3	5.2	10.4	11.5
ATLANTIC PROVINCES	3.2	6.3	10.7	11.6
QUEBEC	6.8	6.4	10.5	11.5
ONTARIO	4.0	7.5	9.4	10.7
MANITOBA	1.1	6.4	11.0	8.1
SASKATCHEWAN	0.5	2.7	13.0	11.1
ALBERTA	2.6	8.4	10.8	16.7
PRAIRIE PROVINCES	1.6	6.4	11.4	13.3
B.C., YUKON & NWT	5.9	8.7	12.0	11.2

	(%)					
	1974	1975	1976	1977	1978	1979
CANADA	16.7	14.9	11.2	7.8	11.6	11.9
ATLANTIC PROVINCES	17.5	14.6	11.0	6.4	14.0	12.1
QUEBEC	17.4	14.4	11.0	7.7	10.4	14.2
ONTARIO	14.2	15.6	10.0	7.8	10.9	9.2
MANITOBA	17.0	10.2	9.8	4.4	8.5	7.8
SASKATCHEWAN	24.2	17.8	12.5	1.9	11.9	11.5
ALBERTA	21.6	22.0	16.1	12.0	14.7	18.5
PRAIRIE PROVINCES	21.0	17.9	13.7	7.7	12.6	14.5
B.C., YUKON & NWT	17.0	9.5	12.3	9.3	13.1	11.5

NOTE: 1960 SALES FIGURES FROM: B. THERIAULT, RETAIL TRADE SECTION, MERCHANDISING AND SERVICES DIVISION, STATISTICS CANADA.
1960 CANADA TOTAL INCLUDES FUEL DEALERS - 323.8\$M;
RESTAURANTS - 569.4\$M; AND LUMBER AND BUILDING SUPPLY DEALERS - 435.9\$M.

SOURCE: STATISTICS CANADA. RETAIL TRADE. CATALOGUE 63-005.
(CANSIM 2431; 78; 2300), 27 JUNE 1980

TABLE IV

**NUMBER OF ESTABLISHMENTS FOR WHOLESALE TRADE, RETAIL TRADE,
TRADING HOUSES, AND MANUFACTURING, 1978**

	<u>1978</u>
WHOLESALE TRADE - TOTAL	47,334
Drugs & Sundries	564
Food	4,382
General Merchandise*	4,613
Other Merchandise**	37,775
RETAIL TRADE - TOTAL	183,465
Drugs & Sundries	4,027
Food***	56,720
General Merchandise	87,083
Other****	35,635
TRADING HOUSES - TOTAL ¹	1,100
ALL TRADES - TOTAL	231,899
MANUFACTURING - TOTAL	52,454 *****

Source: Dun and Bradstreet (1ST) June, 1979.

1. Estimated by Distribution Services Branch.

Includes wholesalers of general merchandise (SIC 612), tobacco products (SIC 615), apparel and dry goods (SIC 617), household furniture (SIC 618).

** Includes petroleum products (SIC 609), motor vehicles and accessories (SIC 619), lumber and building materials (SIC 626), and wholesalers, n.e.s. (SIC 602, 606, 611, 621, 622, 623, 624, 625, 626, 627, 629).

*** Includes retail food stores (SIC 631) — 23,337; and hotels and motels (SIC 881), lodging houses and residential clubs (SIC 883), camping grounds and trailer parks (SIC 884), restaurants, caterers and taverns (SIC 886) — 33,383.

**** Includes retailers of automotive products (SIC 652, 654, 656, 658), and liquor, wine and beer stores. (SIC 696).

***** Canadian Manufacturers' Association total is approximately 31,500 companies (but this figure is low -- according to CMA.)

TABLE V
DISTRIBUTION OF THE EMPLOYED LABOUR FORCE,
BY INDUSTRY, CANADA, 1946, 1977, AND 1979

	1946		1977		1946-1977	1979	
	Proportion of total, all Number industries (Thousands (Percent) of persons)		Proportion of total, all Number industries (Thousands (Percent) of persons)		Average annual rate of growth of employment (Percent)	Proportion of total, all Number Industries (Thousands (Percent) of persons)	
Service producing industries	1,937	41.5	6,422	66.6	4.0	6,904	66.6
Trade - wholesale and retail	619	13.3	1,679	17.4	3.0	1,806	17.4
Transportation, storage and communications	413	8.9	819	8.0	1.8	900	8.7
Finance, insurance and real estate	124	2.7	531	5.0	4.6	553	5.3
Community, recreation, business and personal services, and public administration	781	16.7	3,393	35.2	5.2	3,645	35.1
Goods producing industries	2,729	58.9	3,226	33.4	0.6	3,466	33.4
Primary ¹	1,372	29.4	705	7.3	-2.1	756	7.3
Secondary ²	1,357	29.1	2,521	26.1	2.1	2,710	26.1
Manufacturing	1,148	24.6	1,888	19.6		2,070	20.0
All Industries	4,666	100.0	9,648	100.0	2.4	10,370	100.0

Source: Statistics Canada Labour Force Survey Catalogue 71-001 (CANSIM 2064)
30 June, 1980

NOTE: 1. Includes agriculture, forestry, fishing, and mining.
2. Includes construction and manufacturing.

TABLE VI
 WHOLESALE TRADE, RETAIL TRADE AND
TRADING HOUSES SALES, AND MANUFACTURING SHIPMENTS, 1979
 \$ Million

	<u>1979</u>
WHOLESALE TRADE - TOTAL*1	72,574
Automotive	5,767
Drugs & Sundries	990
Food	14,617
General Merchandise	51,200
RETAIL TRADE - TOTAL ²	89,306
Automotive	23,546
Drugs & Sundries**	2,398
Food***	28,810
Alcoholic Beverages****	3,242
General Merchandise	28,310
TRADING HOUSES - TOTAL ³	5,000
ALL TRADES - TOTAL	161,559
MANUFACTURING - TOTAL ⁴	150,249

Source: 1 Statistics Canada, Wholesale Trade, Catalogue 63-008,
 (CANSIM 114), 1979.
 2 Statistics Canada, Retail Trade, Catalogue 63-005,
 (CANSIM 2300), 1979.
 3 Estimated by Distribution Services Branch.
 4 Statistics Canada, Inventories, Shipments and Orders in
Manufacturing Industries, (Catalogue 31-001, 1979.

* Excludes SIC 606. Coal and Coke products.

** Includes drug stores including proprietary stores,

*** Includes annual sales of \$19,488 M from Statistics Canada Retail Trade Catalogue 63-005; and annual sales of \$9,322 M from Dun and Bradstreet (Datacrown) to cover sales by hotels and motels, lodging and clubs, campgrounds and trailer camps, and restaurant and taverns.

**** Includes annual sales of liquor, wine, and beer except in Quebec, where beer is sold in grocery stores.

TABLE VII
PERCENT DISTRIBUTION OF
GROSS DOMESTIC PRODUCT BY SECTOR,
SELECTED YEARS, (1951-1978)

	<u>%</u>						
	<u>1951</u>	<u>1961</u>	<u>1971</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>
Goods Producing ¹ Sector	53.4	41.3	37.5	38.0	36.6	35.9	35.6
Manufacturing	29.5	26.0	22.9	21.2	20.8	20.4	20.8
Other	23.9	15.4	14.6	16.8	15.8	15.5	14.8
Service Producing ² Sector	45.6	58.7	62.5	62.0	63.4	64.1	64.2
Trade	10.9	12.7	11.9	12.1	12.0	11.3	11.3
Wholesale Trade	3.9	4.8	5.1	5.1	5.1	4.8	4.8
Retail Trade	7.0	7.8	6.8	6.9	6.8	6.5	6.4
Other	35.7	46.0	50.6	49.9	51.4	52.8	53.1
<u>Total All Industries</u>	100.00	100.00	100.00	100.00	100.00	100.00	100.0

Source: Statistics Canada, National Income and Expenditure Accounts,
Catalogue 13-001. (CANSIM Matrix No. 563), 27 June, 1980.

NOTE: 1. Includes agriculture, forestry, fishing, mining, construction, and
manufacturing.

2. Includes transportation; storage; communication; electric power,
gas and water utilities; wholesale trade; retail trade; finance,
insurance and real estate; public administration, and defence;
community, business, and personal service.

While the size of the sector is impressive, its true importance is situational. It is the link between production and consumption; the translator of demand into supply. There is often very close cooperation between manufacturers and retailers when markets are being created for new products. To a certain extent, the sector determines the quality of life: when it is strong, it stimulates the economy; when it is weak, it dampens the level of economic activity.

Despite its size and importance, in comparison to other sectors there is little interaction between the sector and the federal government. At the same time, wholesalers and retailers have entered a period of instability and opportunity which is unprecedented in Canadian experience. The industry needs encouragement to grow and to modify its institutional arrangements so as to increase its potential to serve the Canadian economy.

Since 1975, wholesale and retail sales have grown at an average annual rate of over 1 per cent (TABLE III). Historically, the sector's growth results from

- a) Increases in per capita disposable income;
- b) Population growth;
- c) Expanded product mix;
- d) Higher quality merchandise;
- e) Aggressive merchandising.

Since 1951, the service producing industries of the economy have increased their share of gross national product from 46.6 per cent

to 64.4 per cent in 1978. During the same period the wholesale and retail trade sectors have maintained a relatively stable share with a low of 10.8 percent in 1951 and a high of 12.7 percent in 1961 (Table VII).

Employment

There has been a continuous shift in employment to the service producing industries over the past 30 years (Table V). From 1946 to 1979, the labor force has grown by about 5 million and about 3.4 million of these have been employed in the service producing sector. Employment in the trade sector increased by over 1 million, in manufacturing industries it increased by .9 million, while there has been a decline of 660,000 in the primary industry.

The service sector is frequently the first place of employment and it employs a higher proportion of youths, women and unskilled workers than the manufacturing sector. The importance of the sector as an employer varies from province to province, but it is particularly significant in the eastern and western regions where there is less manufacturing.

Workers in the distributive trades generally have a low level of skills. Many are first-time workers or second wage earners. There is a high degree of turnover and a low level (10 per cent) of unionization. Retailing and wholesaling employ 1.8 million workers (1979) which represents 17.4 per cent of the employed labor force, compared with 20.0 per cent for all manufacturing (Table V).

Capital Stock

The rate of growth in capital stock has been lower in the trade sector than in manufacturing (Table VIII). As a result, the capital stock in the wholesale and retail trades, as a percentage of manufacturing, has been falling steadily since 1961, when it was about 30 per cent. It is now (1979) estimated at 23.4 per cent.

The growth rate in new investment varied considerably: it rose from 2.6 per cent in 1962 to 4 per cent in 1967 and then gradually declined to 2.1 per cent in 1971. Significant recovery began in 1974 but with shrinking profit margins in the trade sector, and the rising cost of capital, the growth rate of new capital investment fell to a record low of less than one per cent in 1979.*

Productivity

Output per employed worker has grown more rapidly in goods producing than in service producing industries (Table IX).

Within the commercial services sector, output per worker in transportation and communications has increased rapidly - the industry being a heavy beneficiary of advanced technology - outpacing the manufacturing average by about 0.8 percentage points per year since 1950. Trade follows with the increase in output per worker averaging

* Statistics Canada, Fixed Capital Flows and Stocks, Catalogue 15-568 (1926-1978) and 13-211 (1972-1978).

TABLE VIII
ANNUAL GROWTH IN GROSS CAPITAL STOCK AND CAPITAL INTENSITY
IN TRADE AND MANUFACTURING,
SELECTED YEARS

Year	Growth in Gross Capital Stock				Capital Intensity in Trade vs. Manufacturing	
	(%)				Trade as % of	
	Trade		Manufacturing		Manufacturing Stock	
	(Current)	(Constant)	(Current)	(Constant)	(Current)	(Constant)
	(\$)	(1971 \$)	(\$)	(1971 \$)	(\$)	(1971 \$)
1961	4.9	3.9	4.7	2.6	30.6	29.9
1965	5.9	3.0	12.0	6.1	26.8	28.9
1971	7.6	2.1	10.1	5.0	24.8	24.8
1975	15.4	3.7	19.5	4.7	22.9	23.9
1976	12.5	3.6	13.5	4.2	22.7	23.8
1977	10.7	3.3	11.2	3.8	22.6	23.6
1978	9.0	2.7	11.6	3.2	22.1	23.5
1979	11.9	2.1	12.6	2.7	21.9	23.4

Source: Derived from Statistics Canada, Fixed Capital Flows and Stocks,
Catalogue 15-568 (1926-1978) and 13-211 (1972-1978)

TABLE IX
 PERCENTAGE CHANGE IN REAL OUTPUT, EMPLOYMENT, MAN-HOURS
 OUTPUT PER WORKER AND PER MAN-HOUR, AND CAPITAL/LABOUR
 RATIO, BY SECTOR, CANADA, 1950-77

	Average Annual Rates (%)					
	Real Output	Employment	Output per Worker	Man- hours	Output per man- hour	Net capital per employed Worker
All industries ¹	4.7	2.5	2.2	1.8	2.9	3.1
Goods sector	4.5	0.8	3.7	0.2	4.3	4.6
Service sector	4.9	4.0	0.9	3.1	1.8	2.0
Commercial service sector ²	5.1	2.8	2.3	2.2	2.9	2.3

1 Total output for all industries excludes owner-occupied dwelling rents

2 The commercial service sector includes wholesale and retail trade, finance, insurance, and real estate, and transportation and communications

Source: Economic Council of Canada Data Bank

2.1 per cent a year, only slightly lower than the national average. Other components of the service producing industries are below national averages.

Several factors have contributed to these differences in productivity growth. Among other things, a lower rate of capital employed per worker, a lower level of training and required skills and a faster decline in the hours of work per employee have all worked to produce a lower productivity gain by the commercial service sector.

Over the 1950-1977 period, plant and equipment purchases were about the same for service and goods producing industries. However, because employment in the service sector rose more quickly, the annual rate of increase in capital per worker has been less than half that in the goods producing sector. In 1977, the service sector had about 37 per cent less capital in plant, machinery and equipment per worker than the goods sector.*

Although productivity gains have been lower, workers in the service industries have managed to obtain wage increases of almost the same percentage as workers in goods producing sectors. As a result, the relative cost of labour has increased nearly twice as fast as productivity.

* In 1977, the service sector had about \$52,000 in gross capital per worker, while the comparable figure for the goods sector was about \$83,000. These figures are based on Statistics Canada mid-year estimates of gross capital stock in current dollars. Statistics Canada, Catalogue No. 13-568 (1926-1978)

The distributive trades have had to be concerned with efficiency and cost savings, but until the mid-seventies there had been an underlying tendency to concentrate on pricing, rather than cost reduction mechanisms, to maintain acceptable levels of profit. Today, rapidly rising costs and consumer resistance to price increases have made efficiency a paramount objective of the distributive trades. This has created a wide range of new initiatives in terms of business format and control and a new attention to cost-saving detail.

Gross Margins

Gross margins* have been shrinking in the retail trades over the past five years, according to an analysis by Statistics Canada.** For the sector as a whole, gross margins have fallen from 26.7 per cent to 24.2 per cent.

Supermarkets have trended even lower, with some as low as 19 per cent. Some of this decrease may have been supported by productivity gains, but most occurred at a time of rapidly rising unit costs of labour, energy and land. The reduction in gross margins is also due to higher prices and hesitation of retailers to pass on all cost increases.

Gross margins are also falling in wholesaling; they are now 17.7 per cent, down from 20 per cent five years ago.** The margins are

* Gross Margin = Net sales less cost of goods sold.

** Statistics Canada. Industrial Corporations (Catalogue 61-003) 1979

lower from the outset because the marketing effort at wholesale does not require the high corporate profile of retail trade.

It is interesting that gross margins for the total economy have, for the most part, remained unchanged through this five year period, indicating that cost increases occurring in the manufacturing and other sectors have generally been passed on. This has not been the case in the distribution services where the negative effects of rapidly rising prices have been borne by this sector to a greater extent than by other sectors.

Debt

The short term debt load (short-term liabilities) for the distributive trades is extremely high. The Canadian average for all retail trade is 136 per cent and for wholesale trade 182 per cent, compared to 68 per cent for all manufacturing.* This reflects the importance of inventory rather than fixed assets in a typical distribution business.

The costs of debt are extremely volatile in the current economic environment as most is short term and susceptible to fluctuations in interest rates. This means that increases in prime rates have a more drastic effect on the viability of firms in retail and wholesale than on manufacturing companies. The value of defaults

* Statistics Canada, Corporation Financial Statistics,
Catalogue No. 61-207, 1977, Table 2A

through bankruptcy has doubled between 1977 and 1978 to \$185 million; representing 30 per cent of national liabilities with the comparable figures for manufacturing being \$88 million and 14 per cent.*

Rates of Return

Statistics available on rates of return cover only the top one-third of companies in distribution services. While the figures are not indicative of the total sector, they are nevertheless significant. In 1977 the after-tax return on capital employed for larger retailers was 15.5 per cent, compared to 6.8 per cent for manufacturing. For wholesale trade it was 8.1 per cent.**

MEDIUM TERM OUTLOOK

The prospects of the wholesale and retail sector will vary with changes in disposable income and the share allocated to consumer goods. With rising energy prices and high interest rates, the share of disposable income spent on energy, shelter and debt servicing will increase. Consequently, the total market is not likely to grow substantially in the foreseeable future, so that any absolute increase in the market share of individual companies will be at the expense of other companies competing in the same subsector. Another market innovation has resulted in retailers moving into the sale of services

* Statistics Canada. Commercial Failures (Catalogue 61-002) 1979.

** Statistics Canada, Corporation Financial Statistics, Catalogue No. 61-207, 1977, pp. 201, 205, and 209.

as a means of enhancing their market share. The regional exceptions are Alberta and British Columbia where population and income are increasing at a fast rate.

The reverse scenario is equally true. If consumer expenditures increase, then the distributive trades will have sufficient leeway to change any number of factors. They could reduce their substantial debt load, invest in new technologies, and increase services as well as increase volume buying and selling. Long term strategic planning is not a strong tradition of the retailing community; however, many members are making decisions based on the pessimistic outlook for at least the next two to three years.

Labour, Technology, and Productivity

It has generally been assumed that output and employment in the distribution services sector were relatively stable and that the relationship between them, "labour productivity", was relatively constant. This assumption was based on limited statistical knowledge and an assumption of little technological change. The medium term outlook cannot continue to rely on this assumption. With the advent of electronic data and communications systems, a great potential now exists for technological and managerial change in retailing and wholesaling. As well, pressure for growth in real wages has hit the labour intensive service sector heavily. This has forced competitive managers to concentrate on reducing costs, in particular the cost of their labour input.

In wholesaling, computerization and automation are increasingly used to handle a more varied product mix. Growth in sales may maintain job creation, but at a decreasing rate. As wholesalers become more efficient, they may capture some of the distributive functions from manufacturers and retailers, reducing labour requirements in those sectors.

Technical advances in the retail sector are just beginning to impact on employment. Full scanning systems coupled with electronic cash registers will greatly enhance efficiency and eliminate some job requirements. This is already taking place in the food subsector which has gone further with labour saving devices than other subsectors. Technical advances will undoubtedly dampen the historical trends of job creation.

The rapid growth of the western provinces and the relative decline of central Canada is leading to a redistribution of opportunities and labour requirements across the country. Quebec and Ontario have to be judged as mature markets with new jobs created through displacement only. These markets may even be over-stored and future adjustments may lead to a stabilization in jobs over the next few years. Alberta and British Columbia will continue to create jobs in the distributive trades at a moderate rate.

In response to a rapidly growing consumer demand in the 1970's, the sector depended on job creation (3.0 per cent annually; Table V) and concentrated on investment in space rather than

improved technology. This led to a deterioration in labour productivity, but has been advantageous to the overall Canadian economy in that large numbers of people were contributing to GNP who would otherwise be at home or unemployed.

There is increasing evidence that the distributive trades are completely reassessing their productivity and labour requirements. This reassessment is a result of a basic leveling in the growth of consumer demand caused by low levels of growth in population and consumer spending. Consequently, efforts to raise productivity and cut costs are now the central themes in corporate strategies.

Investment in technology rather than space will be intensified. The large number of firms in this sector makes the transition to productive maturity a long one with inherent dangers to the smaller businesses that cannot adapt quickly, leaving corporations with a competitive advantage.

It is generally predicted that the latter half of the 1980's will experience labour shortages in the unskilled categories. Even now, labour shortages are appearing in one or two subsectors, for example fast food outlets. By increasing productivity, the distributive trades could be in a position to maintain services to the Canadian public when labour shortages projected for the latter 1980's become acute.

Efficiency

Rising costs, consumer resistance to price rises, and increased concentration of suppliers are some reasons why the distributive trades have made improvement of efficiency a paramount objective. This has created and/or allowed a wide range of new initiatives in terms of business format and control and an attention to cost saving detail which was not apparent five years ago. There is a revolution taking place in the distributive trades; the following few points are indicative of a wide range of new circumstances.

The degree of competition varies from one subsector to another and from one region to another, but all companies see expansion of market area as one of the central criteria for growth. This is the main determinant of capital investment, change in store mix, merger and/or acquisition, and the other multitude of decisions which eventually result in a healthy competitive environment and an expansion of the national economy. In these aspects, the distributive trades are different from the manufacturing sector yet the criteria currently used to judge the degree of acceptability of structural changes have a manufacturing bias.

The relationship between the retailer and consumer, and the retailer and supplier, have been interpreted at the government level from the point of the supplier and consumer. Obligations have been placed on the retailer for which there is no compensation and which entail considerable loss in efficiency. Also, retailers have a "bad press" in that the suspicion always exists that the retailers' market

conduct is nefarious; note the various provincial price inquiries directed against the retailer, as for example in British Columbia and Ontario on the retail food industry. These suspicions have not disappeared even though it has consistently been proved that profits are not excessive.

With rapidly rising energy costs, most large companies have specialists to coordinate energy conservation programs. One development is the computer controlled energy management systems. Given the large number of firms in the sector, the dissemination of knowledge about what is working and what is not is going to be very slow.

The additional costs of transportation is changing supply patterns and shipping requirements. To a certain extent, this is exacerbating supplier/retailer relationships but does present an opportunity for more efficient movement of commodities.

Management

The distributive trade sector as a whole is going through a period of turmoil which is unprecedented in the Canadian experience. Managers of business can no longer complacently assume that business will continue in the future as it did in the past. Today, complacency means being bought out or forced out. The last several years have seen little or no real growth in retail sales over and above floor space increases, which has meant that the competitive situation within the retail trades is becoming even more fierce. In addition, the last

two years has seen a growing consumer resistance to rising prices. The early 1980's will be a time when managers will have to interpret and adjust to a new environment caused by factors such as:

- a) A rapidly changing life style of consumers and growth in the variety and sophistication of consumer demand, including a possible overall downgrading of consumer expectations;
- b) A geographic supply area which is expanding outside normal channels and familiar business practices;
- c) New areas in management/labour relations (including technological labour displacement);
- d) An economic environment which is basically outside the experience of managers but whose impact pervades their business enterprise.

Many managers will be unable to cope effectively with these changes. Those managers who are able will respond by changing supply patterns and merchandising techniques, shifting investment, and initiating efficiency and productivity measures in an effort to control costs. Retailers will gradually shift to more highly skilled labour as they incorporate new technology into their businesses. Managers will spend more and more time outside the firm to ensure adequate supplies; preferably from domestic manufacturers, but from imports if the Canadian manufacturer is unwilling or unable to change commodity lines. Productivity improvements through the development of skilled labour and

management are receiving greater attention in large firms, but remain a real problem for small and medium sized retailers. This process will create a new type of entrepreneur who is already beginning to impact on the business practices of the country. This stimulation within and from the retail trades will provide concepts and products bound to be beneficial through the Canadian economy.

INVESTMENT CLIMATE

The health of the sector is closely tied to the general well-being of the consuming public and general economic conditions. Consequently, economic and social developments that affect profits and the availability of, and demand for, funds for inventory, new store developments, and improved technology will also affect the investment climate in the sector.

Profitability

The profits of the distributive trades are, and will continue to be, squeezed by inflation and unemployment. Rapidly rising prices are being passed on by manufacturers and importers, leading to increased cost of equipment and inventory. At the same time consumers are resisting price increases, cutting back on volume, and substituting low for high value commodities or buying better quality to obtain durability of the product. This process has shrunk gross margins to the point where many firms are in serious financial trouble, and the trend is likely to continue until there is a turnaround in the economy. Until this happens, there is little incentive for new investment.

These negative influences are partly offset by an increased emphasis on improving productivity and tentative moves to capture a market share in other countries, as well as by buoyancy in Alberta and British Columbia.

Financing

The need for future financing comes from three sources, each of which exhibits contradictory trends for capital requirements.

First, inventory financing continues to be the major requirement for most wholesale and retail businesses. Because of the current economic situation, a shift is taking place in the way buyer and supplier relate to each other over credit. This creates problems that have not been resolved. Many manufacturers and other suppliers would like to tighten and reduce credit to the distributive trades, but attempts to do so have reduced their sales at a time when there is already a downward pressure on volumes. Retailers also want to reduce their requirements for inventory capital financing, but they want to do so by reducing volumes rather than by changing the financial arrangements with their suppliers. The adjustments to this problem will be as varied as the number of businesses involved but could cause a fundamental shift in the way business is conducted in the country.

The second area of investment financing relates to long term capital requirements for new stores, warehouses, etc. These requirements have been reduced and will continue to decline for retailers in central Canada in response to the slow market growth.

Expansion will continue in Alberta and British Columbia, but will not significantly change the overall downward trend in demand for long term investment. To a significant degree, developers control the capital funds needed for future expansion. It is generally recognized that further large regional shopping centre developments will be very selective in the East but still common in the West. Community strip plazas will, however, be built, and existing urban space will be refurbished or upgraded for retail purposes. This change will decrease capital requirements generally, but again more acutely in central Canada than elsewhere.

Thirdly, financing is needed for technological improvements in existing firms. Most large companies can finance this investment because the savings generated by reducing labour costs and other operating costs, such as energy, will be large enough to pay for the investments. Small businesses, which comprise the vast majority of firms, may not benefit to the same extent and could very well not obtain the funds required for technological improvements. Ways around the funding problem could be found in leasing or technical groupings by retailers.

DISTRIBUTION CHANNELS

The changed economic and social conditions that have led to tighter inventory control, less new expansion, and increased use of computer technology have also affected the channels of distribution.

The distinct role of the different sectors and the established routes from manufacturers through wholesalers and retailers to consumers are changing in two ways.

First, shrinking gross margins have made retailers more responsive to what consumers want. They will spend time and money to ensure that manufacturers provide goods satisfying given specifications. In some cases, retailers will help organize production lines to ensure that the goods have uniform characteristics and are in stable supply. Increasingly, success demands that manufacturers keep open lines of communication with wholesalers and retailers, and are willing to adapt to new methods and products.

Second, the growing use of computer technology and increasing size of some firms have led to integration of information systems between the distribution and manufacturing sector. This trend, started in response to supply problems, is still spotty, but is likely to expand. One way or another, retailers are becoming major decision makers within the manufacturing process.

The strong influence of the distributive trades on manufacturing is not so apparent in sectors with export programs. But even here, manufacturers of consumer goods for export will seek the advice of wholesalers and retailers because of their knowledge of market characteristics and marketing challenges.

EXTERNAL ORIENTATION

The constant pressure to excel, especially in a market with poor growth potential, has induced several of the larger companies to investigate the possibility of expanding beyond the domestic market. The size and diversity of the industry, its management capability, its link to the Canadian consumer and its involvement in overseas trade are all factors that can allow this sector to make a greater contribution towards a positive international trade and balance of payments position. This contribution can be broken into at least four inter-related areas of endeavour - import replacement, export opportunities, invisible outflows and foreign ownership.

Import Replacement

The potential for import replacement comes from two areas. First, the sector is a major buyer of materials and store equipment for its own use, and second, it is also the direct buyer of consumer goods for resale. A significant portion of both types of product is imported.

In merchandising there is, in addition to new expansion, a constant need to revitalize existing stores by upgrading and modernizing layouts and fixtures in order to maintain the store's image and competitive position. Many of these materials and products are not Canadian sourced even though, for many items, the Canadian market is sufficiently large to support Canadian manufacture. To match retail/wholesale demand with manufacturers' supply will take concerted and united effort at a level not normally found, due to the diversity and

number of businesses. Retailers are beginning to coalesce into groups or utilize groups or agencies able to understand and transmit their requirements to manufacturers, and Canadian manufacturers need to be made aware of the requirements of the sector and be encouraged to establish new product lines specifically for this sector.

The distributive trades are very conscious of the fact that, as a sector, their health depends upon the prosperity of the Canadian consuming public. Thus, as a group they have been supportive of programs and policy that would increase national prosperity. In fact, there is a constant flow of information between some retail companies and some manufacturers, but the advantages would be much greater if this interchange of information involved all sectors; distribution, manufacturing and, where appropriate, government. Canadian production of goods for Canadian consumers would gain from faster and universal information channels between these sectors.

Export Opportunities

The Canadian wholesale and retail community has begun looking at new areas of endeavour in light of a long-term structural slow-down in the rate of growth in the domestic market. One avenue of expansion receiving increasing attention is marketing abroad; particularly into the United States, but also into other countries. The basic strength of the distributive trades is expertise in marketing and an understanding of the operation of market channels. Wholesalers in particular have the advantage of facilities plus a wide range of products, some of which could be competitive in almost any market.

Two areas of hesitation are slowing the rate of growth of entry by this type of Canadian businessman into the export market. The first is that those who have excellent contacts for imports have not actively pushed for an effective two-way flow of commodities. The second area is felt to be lack of management and management's unwillingness to participate in adventures abroad. There is a need to address these problems as most companies that have entered the international sphere do become committed to that kind of activity.

Invisible Monetary Flows and Foreign Ownership

In the service sector, Canada has the worst record for invisible monetary flows in the O.E.C.D. The recent increase in acquisitions of small retail chains, in the United States primarily, by Canadian companies are among the first steps in the creation of distribution multi-nationals owned in Canada. Because the capital/sales ratio is low, acquisitions in the service sector do not require as large an outflow of money as manufacturing acquisition. The possibilities of royalties, profits and other invisible flows coming back to Canada would thus occur earlier than would normally be expected.

The trend so far has been to supply some goods to their acquisitions from the distribution system in Canada. While this supply practice has limits, it does provide an additional market channel for Canadian producers into markets where they may have had difficulty becoming established in the past.

There has also been a growing trend of foreign acquisition in the Canadian service industry. It is recognized that such acquisitions contribute little to the Canadian economy and have the potential to cause serious long term disruptions to government objectives. This trend needs to be understood and discouraged in order to retain the dominant position of Canadians in this sector, while at the same time recognizing that the total service sector is becoming more international in its orientation.

POLICY & REGULATION PROCESS

Government policy has in the past been formulated to meet particular objectives in primary and secondary sectors or to meet social objectives but the distributive trades have been essentially left out of policy development. This situation has come about because of the innocence with which government views the distributive trades; a situation which government is currently trying to correct through a formal consultative process. Even though the magnitude and heterogeneity of the sector seems overwhelming, government is trying to determine how policy written to solve problems in other areas will impact upon the distributive trades.

The regulatory process is another area where frequent and indepth consultation is needed, even in areas where clientele other than the distributive trades are being served. Because of their function as the domestic market channel, the distributive trades can make positive comment on a wide range of regulations. In the process this can reduce possible inefficiencies or loss of profit and can

enhance the trades' ability to service the consuming public.

The amount of work required to take action arising from the consultative process is substantial but the pay-offs may be great. In addition, if and when government/ distributive trades interaction becomes closer and more complementary, it could lead to substantial increases in the ease with which their respective objectives are met. Such cooperation requires an informed understanding by government of the business climate and requirements of the sector, and an informed understanding of government processes and objectives by businessmen in the sector.

SOCIAL CONTRIBUTIONS

The above sections have mainly dealt with the economic issues of sales, employment, investment, capital stock, and location. The primary objective of the distributive trades is, however, to serve consumers by ensuring that they obtain the goods and services they want, when and where they want them. The efficient execution of these functions creates a flexible society, eases the attainment of social and economic goals, and contributes to a rising standard of living for Canadians.

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