Distilleries

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Canada

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I N D U S T R Y P R O F I L E

1990–1991

DISTILLERIES

FOREWORD

In a rapidly changing global trade environment, the international competitiveness of Canadian industry is the key to growth and prosperity. Promoting improved performance by Canadian firms in the global marketplace is a central element of the mandates of Industry, Science and Technology Canada and International Trade Canada. This Industry Profile is one of a series of papers in which Industry, Science and Technology Canada assesses, in a summary form, the current competitiveness of Canada's industrial sectors, taking into account technological, human resource and other critical factors. Industry, Science and Technology Canada and International Trade Canada assess the most recent changes in access to markets, including the implications of the Canada-U.S. Free Trade Agreement. Industry participants were consulted in the preparation of the profiles.

Ensuring that Canada remains prosperous over the next decade and into the next century is a challenge that affects us all. These profiles are intended to be informative and to serve as a basis for discussion of industrial prospects, strategic directions and the need for new approaches. This 1990–1991 series represents an updating and revision of the series published in 1988–1989. The Government will continue to update the series on a regular basis.

Michael Wilson

Michael H. Wilson
Minister of Industry, Science and Technology
and Minister for International Trade

Structure and Performance

Structure

The Canadian distilling industry consists of establishments producing most types of distilled spirits, including Canadian whisky, rum, vodka, gin, liqueurs, brandy, spirits coolers, *eaux de vie* and basic ethyl alcohol. The products are categorized as either "dark goods," such as whisky, which require aging in wood and take on colour during the process, or "white goods," which may be aged but remain colourless. Canadian whisky is the most important product, since it accounts for more than 70 percent of the value of shipments and over 95 percent of exports. It is followed by rum and vodka, each of which account for approximately 10 percent of shipments.

In 1989, the most recent year for which a complete set of Statistics Canada data is available, the industry shipped product worth $891 million from 25 establishments, and employed 3 997 people. Plants are located in all regions of Canada but are concentrated in Ontario and Quebec. The main production inputs to the distilling industry are grain and packaging.

The industry has a strong export orientation. In 1989, exports were worth an estimated $446 million and imports amounted to $204 million (Figure 1).

The industry is dominated by multinational companies: the Seagram Company (Joseph E. Seagram & Sons in Canada), Allied-Lyons (Hiram Walker and Corby), International Distillers and Vintners (Gilbey), Guinness (Schenley) and Bacardi. The parent companies of these firms have worldwide holdings that include other distilling and winery operations, other beverage operations and non-beverage related industries.

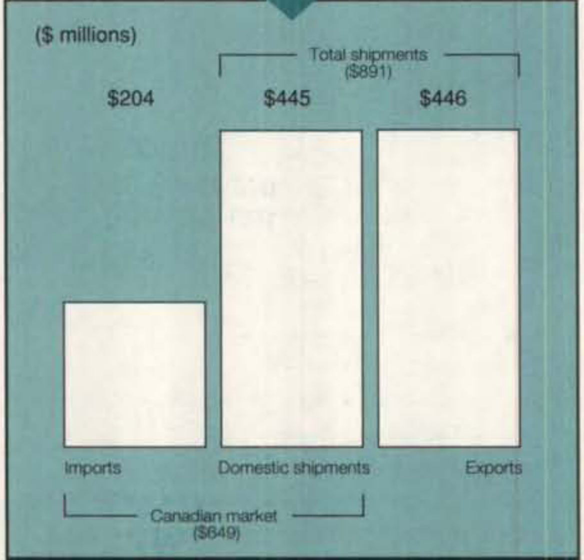

Figure 1 — Imports, Exports and Domestic Shipments, 1989

The distilling industry operates within a highly regulated environment. Both federal and provincial governments have a significant influence on its operations and profitability. The federal government controls aspects of plant layout, product standards and product labelling, along with levels of excise duty, federal sales tax and the price of grain inputs. Provincial governments maintain control over retailing and distribution of distilled spirits. They also influence the price and availability of distilled spirits in the marketplace through provincial markups, taxes and liquor board pricing policies. Both levels of government apply restrictions on advertising and promotion.

Performance

The performance of the Canadian distilling industry continues to be influenced by reduced demand, both domestically and in the U.S. market. Between 1980 and 1989, total alcohol consumption in Canada declined by almost 7 percent, or by 13.8 million LAB (litres of absolute alcohol). Consumption of distilled beverages declined at a greater rate. Per capita consumption of distilled beverages, based on the population aged 18 years and over, declined from 4.56 LAB to 3.24 LAB, or almost 30 percent over the same period.

Industry representatives attribute the reduction in total alcohol consumption to increases in rates of taxation and resultant price increases. Based on alcohol content, distilled spirits have a higher tax rate than other beverage alcohol. Federal excise duties for spirits are $11.07 per LAB, compared with $5.60 per LAB for beer with 5 percent alcohol and $4.27 per LAB for wine with 12 percent alcohol. Provincial taxes and markups magnify the impact of increases in federal levies because they are generally applied on an ad valorem basis to the delivered cost of the product, inclusive of federal duties and taxes. Other major factors contributing to the decline in per capita alcohol consumption were the effectiveness of drinking and driving campaigns as well as consumers' health and safety concerns.

Canadian whisky is the mainstay of the industry and continues to account for over 30 percent of the domestic market. In the decline of the spirits market, Canadian whisky experienced a loss of 7.5 percent of market share, compared with a loss of 3.4 percent for gin, the only other category in decline. Spirits coolers were introduced into the market in 1985. While initial sales grew rapidly, growth has slowed significantly and, in 1989, spirits coolers accounted for less than 2 percent of the market. This product category, however, increases exposure of a corporate name and provides consumers with an alternative beverage.

Investment by the industry in new machinery and equipment has been strong, due to the acquisition and rationalization activity that has been taking place. Operations have been consolidated and modernized to improve production and administrative efficiencies. Most of the rationalization has taken place in distilling operations, which are more capital intensive than bottling operations. In spite of the rationalization, current capacity utilization rates are only 52 percent of distilling capacity and 60 percent of bottling capacity. Nonetheless, this is a slight improvement over 1988 levels, when capacity utilization rates were less than 50 percent of distilling capacity.

The export market continues to be a vital component of the industry. Bulk rather than bottled whisky has traditionally accounted for about 60 percent of exports, with the United States being the major market. Exports have continued to increase. The strategy of developing internationally recognized brands and the attention paid to other markets has resulted in increased exports of bottled products to the European Community (EC) and Pacific Rim countries.

Imports, comprised mainly of Scotch whisky, liqueurs, brandy, gin and vodka, have been slowly gaining market share and accounted for 31 percent of the value of the Canadian market in 1989. Canadian distillers, through their international affiliations, are often import agents and marketers for major brands of spirits. Domestic companies benefit from revenues gained in this role.

Both domestically and internationally, the industry has chosen to consolidate its product lines, focus advertising and promotion expenditures on premium products and develop international brands. These actions have helped reduce

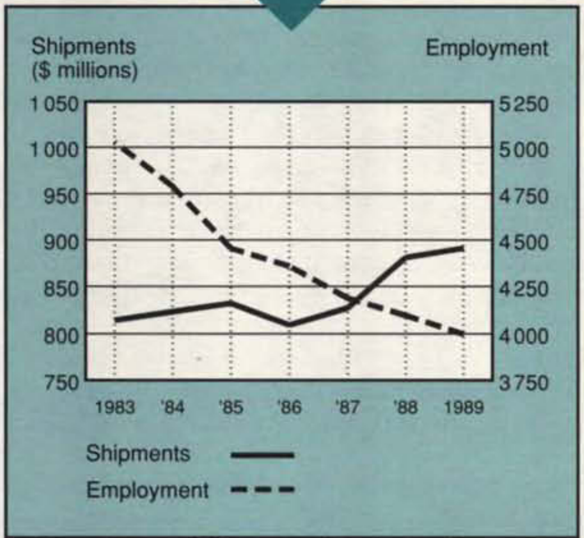

Figure 2 — Total Shipments and Employment

advertising expenditures by almost 5 percent, excluding expenditures on spirits coolers, and may account for the increased demand for, and exports of, bottled products. The combined influence of increased sales volumes because of acquisitions, a slower decline in year-to-year sales than experienced in the mid-1980s, and the impact of revenue derived from offshore and non-distilling operations have helped the industry maintain steady financial performance (Figure 2).

Strengths and Weaknesses

Structural Factors

Canadian distillers have a solid, worldwide reputation for quality, particularly for Canadian whisky. Canadian regulations require that all spirits, other than rum and brandy, be produced from cereal grain or cereal grain product.

The Canadian industry is competitive with other distillers, particularly its U.S. counterparts, in producing "dark goods." In contrast, "white goods" may be produced in the United States more economically as by-products of other grain-processing operations and because of less restrictive product standards.

Grain inputs, primarily corn, represent approximately 10 percent of the cost of production. The other major component is packaging material, which represents almost 40 percent of the cost of production. The industry is also sensitive to interest costs while the product is held in inventory, because a minimum of three years is required to age Canadian whisky.

Taxation levels and their impact on consumption continue to be a concern to the industry, which considers domestic taxation to be the major contributing factor in the decline in consumption of spirits. Taxes represent approximately 85 percent of the retail price of distilled spirits. Effective 1 January 1991, the 7 percent goods and services tax (GST) replaced the 19 percent federal manufacturers' sales tax levied on warehouse shipments, and an increase in excise levies was applied. Prior to this revision, domestic excise duties had not been increased since February 1986, although there had been increases in both the federal sales tax and provincial levies.

Since the overall consumption of alcohol is declining, firms in the distilling industry must compete for market share in a contracting market. Brand recognition is very important to the industry. However, the industry is limited in its promotional efforts in the domestic market because restrictions on advertising and promotion of distilled spirits are greater than those applied to competing beverages. Distribution, product availability and pricing are also restricted, since distilled spirits in Canada are sold only through provincial liquor control outlets.

The industry has capitalized on its successful promotion of premium brands abroad. Canadian whisky enjoys a quality reputation, particularly in the United States, where it is recognized as a distinctive product and is also perceived as "lighter" than competing whiskies. Insofar as the industry depends heavily on exports, it is quite sensitive to exchange rate fluctuations.

Trade-Related Factors

All countries levy tariffs on distilled spirit imports. Canadian tariffs are among the lowest in the world, ranging from \$0.20 per proof gallon for whisky to \$1.00 per proof gallon for rum. Some spirits not produced in Canada, such as tequila, enter duty-free. In accordance with the provisions of the Canada-U.S. Free Trade Agreement (FTA) implemented on 1 January 1989, whiskey and rum traded between the two countries enter each country duty-free. On other spirits, U.S. tariffs range from U.S.\$0.24 per proof gallon for Scotch and Irish whiskies to U.S.\$3.40 per proof gallon for some brandies. Relevant excise levies on imports, equivalent to those applied to domestically produced products, also apply in both countries.

Upon implementation of the FTA, Canada granted U.S. products national treatment for listing, distribution and price markups. In addition, Canada rescinded measures requiring blending of distilled spirits imported in bulk from the United States with domestically produced distilled spirits prior to bottling. Both countries granted reciprocal recognition of bourbon and Canadian whisky as distinctive products. Tariffs on whisky and rum were eliminated immediately and other tariffs are being phased out in 10 annual steps. Relevant excise duties and taxes will continue to be applied by both countries.

Complex systems of tariffs and taxes are in effect in the EC and Pacific Rim countries. These tariffs, coupled with non-tariff barriers, effectively restrict entry to these countries.

Non-tariff barriers have a significant influence on world trade in distilled spirits. One of the critical elements of trade is whether the legislation of the importing country recognizes something as a distinctive product of the originating country. Such recognition offers protection from competition from adulterated or misrepresented products, adds to a product's prestige and augments marketing efforts. Canada recognizes bourbon as a distinctive product of the United States, and Scotch and Irish whiskies, cognac and Armagnac as distinctive products of the EC. Although Canadian whisky has gained this recognition in the United States, Canadian distillers have been seeking it worldwide, particularly in the EC.

In 1988, a General Agreement on Tariffs and Trade (GATT) panel found the pricing, distribution and retailing practices of provincial liquor boards to be inconsistent with international trading rules. Canada reached an agreement with the EC, the complainant, to end discriminatory practices and accord national treatment to the listing, distribution and price markups of distilled EC products. A special provision was made to allow for differential price markups for Ontario brandy sold in Ontario. This provision will be phased out by 1993. The elements of the agreement were later extended on a multilateral basis and now apply to distilled spirits imported from all of Canada's trading partners.

Technological Factors

The distilling industry in all countries uses traditional, mature technology. The Canadian distilling industry is as technologically sophisticated as its major competitors. It has access to new technologies worldwide through its intercorporate linkages with other distilling companies. Technology development is primarily carried out by production equipment suppliers, while distilling companies focus on product development.

Other Factors

The industry is not a major contributor to pollution. Its spent grains are sold as animal feed, and its production processes attempt to recover and redirect heat. Most spirits are not sold in single-serving containers the way many soft drinks and fruit juices are, so they do not pose a significant litter problem. Spirit containers are compatible with most consumer waste recovery systems. The distilling industry, like all food processing industries, is faced with the challenges of the National Packaging Protocol, a national initiative developed with the participation and co-operation of Canadian industry and adopted by the Canadian Council of Ministers of the Environment in March 1990. The major aim of this protocol is to reduce by 50 percent the amount of packaging going to solid waste disposal by the year 2000, relative to the base year of 1988.

The distilled spirits industry in Canada was one of the first to incorporate the "Mobius loop," the symbol for recyclable products, on all of its packaging. Environmentally safe inks and dyes are used, and companies are continuing to take steps to reduce excess packaging. The industry is working with all the provinces to develop container return and recycling programs.

Evolving Environment

Public attitudes towards drinking and driving, health-related concerns over the consumption of alcohol, the aging of the population and concern over price levels will continue to dampen demand for distilled products in the North American market. This decrease in consumption is likely to dictate some further rationalization and consolidation in the industry. Production of Canadian whisky will continue to be a mainstay of the domestic industry.

In the domestic market, the industry has asked the Canadian Radio-television and Telecommunications Commission (CRTC) to allow firms to advertise on television and other electronic media, from which the industry is currently excluded. Increased advertising would likely be in the form of public service messages to educate consumers about responsible attitudes towards alcohol consumption.

The recent increase in excise levies that accompanied the introduction of the GST will not likely have a major impact on the distilling industry, as the overall tax is expected to be revenue neutral. Changes in taxation at the licensee, or hospitality, level could increase prices to consumers. The impact of these increases upon "on premise" consumption, such as in restaurants and bars, is uncertain.

Exports will be crucial to providing industry growth. The United States will continue to be the major export market, although it too is experiencing a decline in the consumption of distilled spirits for many of the same reasons as in Canada. Since the FTA eliminated tariffs on whisky and rum immediately and is phasing out other tariffs in 10 annual, equal steps, it will have little new impact upon the industry.

The industry is focusing on global brands. There is a worldwide trend to lowering trade barriers, which will likely benefit Canadian exports of distilled products. The Pacific Rim countries of Japan and the Republic of Korea, where consumption of spirits is increasing, will become increasingly important.

The current round of the multilateral trade negotiations under the GATT could result in reduced tariffs and non-tariff barriers, which have impeded growth in some countries, including Japan and the Republic of Korea. Also being discussed are the broad issues of appellations and product recognition in relation to protection of intellectual property. The Canadian government will continue to press for a wider recognition of "Canadian whisky" as a distinctive product.

Competitiveness Assessment

The Canadian industry is part of the operations of some of the largest distilling companies in the world. These companies have both the market expertise and the financial resources to pursue opportunities as they arise. The industry is internationally competitive and will remain so, especially in the whisky market.

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

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PRINCIPAL STATISTICS[a]

	1973[b]	1983	1984	1985	1986	1987	1988	1989
Establishments	31	32	32	30	31	26	25	25
Employment	6 209	5 027	4 790	4 454	4 358	4 187	4 096	3 997
Shipments ($ millions)	433	814	823	832	809	827	881	891[c]
GDP[d] (constant 1981 $ millions)	377.7	300.2	276.2	270.2	237.4	226.4	234.2	251.2
Investment[e] ($ millions)	22.4	17.9	14.4	15.1	21.4	22.4	26.6	21.2
Profits before tax and non-recurring items[f] ($ millions)	140.1	224.8	94.5	123.3	59.6	90.2	N/A	N/A
(% of income)	32.3	27.6	11.5	14.8	7.4	10.9	N/A	N/A
Profits after tax[f] ($ millions)	78.7	177.0	51.7	75.7	92.5	42.9	N/A	N/A
(% of income)	18.2	21.7	6.3	9.1	11.4	5.2	N/A	N/A

[a]For establishments, employment and shipments, see *Beverage and Tobacco Products Industries*, Statistics Canada Catalogue No. 32-251, annual (SIC 1121, distillery products industry).

[b]Data for this year are not strictly comparable with data for other years shown, due to changes in the definition of the industry that were introduced in the *Standard Industrial Classification, 1980*, Statistics Canada Catalogue No. 12-501.

[c]See *Monthly Survey of Manufacturing*, Statistics Canada Catalogue No. 31-001, monthly.

[d]See *Gross Domestic Product by Industry*, Statistics Canada Catalogue No. 15-001, monthly.

[e]See *Capital and Repair Expenditures, Manufacturing Subindustries, Intentions*, Statistics Canada Catalogue No. 61-214, annual.

[f] See *Corporation Financial Statistics*, Statistics Canada Catalogue No. 61-207, annual.

N/A: not available

TRADE STATISTICS

	1973[a]	1983	1984	1985	1986	1987	1988	1989
Exports[b] ($ millions)	232	354	388	363	360	367	440[d]	446[d]
Domestic shipments ($ millions)	201	460	435	469	449	460	441	445
Imports[c] ($ millions)	59	157	165	153	174	158	160	204
Canadian market ($ millions)	260	617	600	622	623	618	601	649
Exports (% of shipments)	53.6	43.5	47.1	43.6	44.5	44.4	49.9	50.1
Imports (% of Canadian market)	22.7	25.4	27.5	24.6	27.9	25.6	26.6	31.4

[a]Data for this year are not strictly comparable with data for other years shown, due to changes in the definition of the industry that were introduced in the *Standard Industrial Classification, 1980*, Statistics Canada Catalogue No. 12-501.

[b]See *Exports by Commodity*, Statistics Canada Catalogue No. 65-004, monthly.

[c]See *Imports by Commodity*, Statistics Canada Catalogue No. 65-007, monthly.

[d]Export data for 1988 and 1989 are derived from figures provided by the Association of Canadian Distillers.

SOURCES OF IMPORTS[a] (% of total value)

	1983	1984	1985	1986	1987	1988	1989
United States	8	9	7	8	8	8	9
European Community	73	69	73	70	73	70	71
Asia	–	–	–	–	–	–	–
Other	19	22	20	22	19	22	20

[a]See *Imports by Commodity*, Statistics Canada Catalogue No. 65-007, monthly.

DESTINATIONS OF EXPORTS[a] (% of total value)

	1983	1984	1985	1986	1987	1988	1989
United States	95	97	95	96	90	76	85
European Community	2	1	2	1	2	3	5
Asia	1	1	1	1	6	18	6
Other	2	1	2	2	2	3	4

[a]See *Exports by Commodity*, Statistics Canada Catalogue No. 65-004, monthly.

REGIONAL DISTRIBUTION[a] (average over the period 1986 to 1988)

	Atlantic	Quebec	Ontario	Prairies	British Columbia
Establishments (% of total)	4	23	49	17	7
Employment (% of total)	X	26	61	X	X
Shipments (% of total)	X	24	64	X	X

[a]See *Beverage and Tobacco Products Industries*, Statistics Canada Catalogue No. 32-251, annual.

X: confidential

MAJOR FIRMS

Name	Country of ownership	Location of major plants
Corby Distilleries Limited	United Kingdom	Walkerville, Ontario
Gilbey Canada Inc.	United Kingdom	Toronto, Ontario Lethbridge, Alberta
Schenley Canada Inc.	United Kingdom	Valleyfield, Quebec
Joseph E. Seagram & Sons Limited	Canada	Montreal, Quebec Gimli, Manitoba
Hiram Walker Group	United Kingdom	Walkerville, Ontario Winfield, British Columbia

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