Revolutionary Change: The Liquor Control Board of Ontario, 1985-2005

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Please note: This essay summarizes research from part of the author's doctoral dissertation which will examine the evolution of the Liquor Control Board of Ontario and the privatization of the Alberta Liquor Control Board. It should be treated as a 'work in progress' and the author welcomes feedback and comments. As such, he asks that no direct reference or attribution be made from it without his prior consent.

This is a story. A story of how a publicly-owned and operated retailer has fundamentally changed its operations and ultimately, its function, by providing citizens who want to purchase alcohol with high value for their consumer dollar. Shopping at the Liquor Control Board of Ontario (LCBO) is a pleasurable experience. Its stores are well-designed and laid-out, and carry a wide variety of beverage alcohol from all over the world. Its staff is helpful, knowledgeable, and dedicated to selling alcohol in a socially responsible manner.[1] Its customer satisfaction levels are well over 70% and, in 1998, the Retail Council of Canada awarded the LCBO its innovator of the year award.[2] The LCBO is the foremost retailer of beverage alcohol products in North America.[3] This change is nothing short of remarkable. As recently as twenty years ago, many LCBO stores were poorly located and dreary, offering limited product selection. The LCBO's original function, after all, had been to *control* liquor sales and consumption amongst the general public, not to make it pleasurable.

This paper will begin by describing the evolution of the LCBO from 1985 to the present-day. It will be primarily descriptive, and will outline the major policy, operational and personnel changes that occurred during this period. Next, the paper will examine and describe certain variables, such as revenue, the role of other market actors (suppliers and

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[1] Murie, Andrew, CEO of Mothers Against Drunk Driving (MADD), Interview, November 30, 2005.
[2] LCBO, Annual Report, 2003-2004, pp. 28 and 33, respectively.
[3] Dunning, Rowland, Executive Director of the Canadian Association of Liquor Jurisdictions, Phone Interview, November 2, 2005.

other alcohol retailers), Ontario wine producers, public health advocates, and the political context, which are critical to understanding how and why an expansion and alteration of this state-owned enterprise occurred.[4] This section of the paper will be more analytical in nature. As will be discussed in further detail later, a study of these variables reveals that, while all of them had a role to play in the LCBO's transformation over recent years, the need to increase revenue from this Crown-owned retailer, particularly under the reign of Mike Harris's Conservatives, was the primary driving factor for institutional change at the LCBO during this period.[5]

Our story starts in 1985. Admittedly, the choice of this point in time to begin is slightly arbitrary, since some important liberalizing changes alcohol policy had already occurred at the LCBO and within Ontario society more generally prior to 1985. By the early 1960s, for example, a permit was no longer required to purchase alcohol; in the early 1970s the drinking age was lowered from 21 to 18 (and then subsequently increased to 19);[6] as well, by this time, the LCBO had introduced some self-serve stores. The

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[4] Norman Giesbrecht, Andree Demers, Alan Ogborne, Robin Room, Gina Stoduto and Evert Lindquist (Eds) Sober Reflections: Commerce, Public Health, and the Evolution of Alcohol Policy in Canada, 1980-2000 (Montreal: McGill-Queen's University Press, 2006). This anthology comes closest to providing an explanation of the divergent outcomes between Alberta and Ontario's alcohol distribution systems which is the subject of the author's upcoming dissertation. It also provides one of the only secondary sources examining the evolution of the LCBO and, accordingly, is a valuable source of information for this dissertation. The authors' descriptions of Alberta and the evolution of its distribution system are quite reasonable, and their findings are congruent with those described in other secondary sources, as well as with the findings of this researcher. However, their views on the evolution of the LCBO are somewhat problematic. They conclude that the Harris Tories did not sell the LCBO because of the political pressure of the Ontario brewers (Brewers Retail) and the Ontario wine industry (both of which they highlight as highly significant factors), because of the revenue earning potential of the LCBO, and because effective opposition campaign by the LCBO's labour union. The first three reasons for retaining public ownership of the LCBO are supported by the author's own research; however, the final factor was not found to be a significant variable. Further, the author's findings indicate that revenue was by far the most important factor in the Ontario government's decision to retain public ownership of the LCBO. Opposition from the Brewers and the domestic wine industry were certainly important factors, but both were secondary when compared to the LCBO's capacity to produce enormous revenue for the province. The lack of parallel institutions like the Brewers Retail and the indigenous Ontario wine industry in the other provinces that have retained their government-owned liquor retailing businesses constitutes further evidence, in the author's eyes, that these factors were secondary and that revenue was likely the principal reason the Ontario government chose to keep the LCBO in public hands. Giesbrecht's *et al*'s sources, too, are problematic. Their interviews were anonymous, and none of the individuals interviewed for this thesis indicated any contact with other researchers. The authors also relied heavily on newspapers as primary sources, which is troubling. The biggest problem, however, with the papers in this anthology, is that they fail to correctly describe the Harris Conservatives' political motivations for retaining the LCBO. While the book contains a chapter that explains why the Tories did not privatize the LCBO, it fails to explain why they decided to retain public ownership and expand it. Finally, Giesbrecht *et al* argue that there is a causative relationship between institutional configuration (the structure of an alcohol distribution system) and individual preferences (how much and how individuals will consume alcohol). The authors assert that both Ontario and Alberta's retailing models illustrate a dangerous shift in policy that has resulted in increasing social harm caused by alcohol consumption. Their ardent stance on this matter precludes a clear focus on the *political* reasons for the divergent outcomes.

[5] Tsubouchi, David, Former Minister of Consumer and Commercial Relations (1996-2000) and Former Chair of Management Board of Cabinet (2001-2003), Interview, October 12, 2005; Brandt, Andrew, CEO, LCBO, Interview, November 8, 2005; Guy Giorno. Held various positions, including Chief of Staff, in Premier's Office of Mike Harris, 1995-2002, Interview, November 29, 2005.

[6] Heron, Craig, Booze: A Distilled History (Toronto: Between the Lines Publishing, 2003), p. 333.

LCBO of 1985, however, was, for the most part, still an archaic government institution with dingy stores, an inefficient distribution network, no real marketing capacities, and untrained, surly (male) staff. It was grossly undercapitalized, with few resources dedicated to maintaining its infrastructure.[7] To provide some tangible examples of the LCBO and how it functioned at this time, in 1988 there were still no computers in use its stores. All accounting and payroll functions were done manually. The LCBO also had no point-of-sale information, and thus, quarterly sales results took six months to reach upper management. In addition, the LCBO during was, during this period, a bastion of 'petit' and 'grand' patronage with store and executive positions, respectfully, filled by well-connected individuals.[8]

This would have been the optimal time to privatize the LCBO. These observations are not meant to criticize the LCBO of 1985. The state of affairs at the LCBO at this time reflected the function it played and was expected to play with respect to liquor distribution; to *limit* alcohol consumption in Ontario. The LCBO was not meant or originally designed to be a dynamic retailer.

Beginning in the late 1980s, however, changes vital to the LCBO's function and operations were introduced.[9] In 1985, David Peterson and his Liberals were elected in Ontario. They only won enough seats for a minority government, however, and to secure the balance of power, Peterson concluded an accord with Bob Rae's NDP, an accord that lasted for two years[10]. During the election campaign, Peterson's Liberals had promised to introduce beer and wine into corner stores. This promise was never fulfilled, as Rae and his NDP did not support such an initiative, viewing it as a movement towards privatization and thus a threat to the LCBO's unionized workers. Peterson's campaign promise did, however, serve to highlight, in the eyes of both the government and the public, the condition of the Ontario liquor retail market. As a result of his accord with Rae, Peterson agreed not to change the market; however, he stipulated that the LCBO had to be 'modernized,' as it was an embarrassment to the government in its current state. Rae agreed wholeheartedly.[11]

Peterson's modernization plan was spearheaded by Jack Ackroyd, former Chief of Police of Toronto, who was appointed to the position of Chief Executive Officer (CEO) of the LCBO in 1986. During this early period, Ackroyd was assisted by Len Pitura, a former civil servant, who was appointed executive vice-president (second-in-command), and was to play a pivotal role in the LCBO's transition. These two appointments were critical milestones in the evolution of the LCBO. Shortly after assuming their positions, Ackroyd and Pitura fired almost all of the LCBO's upper management personnel (vice-presidents and one lower level), and the entire board of directors. They then set about hiring a new board of directors. This new board contained three very successful businessmen and one medical doctor, whose role was to temper the entrepreneurial instincts of her board colleagues and ensure the board did not lose sight of the LCBO's obligation to sell alcohol in a socially responsible manner.[12] When the board members

[7] O'Brien, Barry, Director, Corporate Affairs, LCBO, Interview, November 3, 2005.
[8] Gee, Larry, Former Chief Operating Officer, LCBO, 1988-2001, Interview, December 20, 2005.
[9] O'Brien, Barry, Interview, November 3, 2005.
[10] http://en.wikipedia.org/wiki/Bob_Rae#Premier
[11] Gee, Larry, Interview, December 20, 2005. Information for entire paragraph was derived from this source.
[12] Ibid.

agreed to their new positions, they assumed them with one clear stipulation: the government was not to interfere in the day-to-day operations of the LCBO. Previously, in addition to patronage, the government had selected LCBO store sites and negotiated its leases. Not surprisingly, these were very lucrative deals for landholders who, more often than not, were well connected to the members of the bureaucracy or politicians. The board members were unwilling to take on the monumental task of reforming this institution if hands-on political interference with LCBO operations of the type described above were to continue.[13]

Next, in 1988, Ackroyd and Pitura hired a former Dominion Store executive, Larry Gee, as the LCBO's Chief Operating Officer (COO).[14] Mr. Gee was a very competent, hardworking professional and can be credited with implementing many vital changes at the LCBO from the time he was hired until his retirement in 2000.[15] Ackroyd and Pitura also hired Murray Kane as head of Human Resources. Misters Kane, Pitura and Gee subsequently went on a hiring spree, replacing the senior management officials they had fired with experienced private sector executives. Finding (and hiring) these executives was a difficult task, since the wages paid at the LCBO were relatively low and few business executives at the time were interested in working for such an archaic institution. Nevertheless, after a year and a half, the three were able to put together a solid management team and start the process of 'modernization'.

Most of the early changes made to the LCBO's operations and organizational structure during this initial period are described in a report called "Project 87," which contained recommendations for change. The recommendations contained in Project 87 were, in turn, based on the findings of an external consulting firm, Mercer Limited, which had been hired to conduct a thorough examination of the LCBO and its operations and produce its own report (aptly titled The Mercer Report)[16] including suggestions for change. The LCBO ended up adopting and implementing many of the key recommendations contained in both reports. In particular, the LCBO heeded calls to reorganize its managerial structure in order to enhance control and accountability. It also heeded calls to strengthen the powers of its CEO and Board of Directors. The reports also recommended that the LCBO take steps to improve its merchandising and distribution systems renew its focus on customer service and satisfaction and, perhaps most importantly, increase financial revenue earned.[17] These recommendations were adopted and implemented.

The entire organizational structure of the LCBO had to be modernized. All facets of the LCBO had to be rebuilt (everything from marketing, distribution, accounting, human resources, information technology etc.). The stores and wholesale facilities also required improvement. However, the LCBO had very limited capital funds. It had, in fact, been starved of capital. To give an example, in 1988, the amount of money for budgeted

[13] Ibid.
[14] The CEO in the LCBO hierarchy is the most senior position. The CEO acts as a liaison between the LCBO and its political masters. The COO is second-in-command and is responsible running its day-to-day operations.
[15] Lewin, Julian, Former senior Vice-President, LCBO, 1986-1996, Interview, December 7, 2005.
[16] The Mercer Report, (Toronto: LCBO, 1987).
[17] Ackroyd, Jack W. Project 87: The Change and the Challenge: A Special Report from the Chairman, (Toronto: LCBO, 1987)

for repairs and capital improvements was $6 million, to cover a network of 630 stores.[18] In the early days of LCBO's modernization, those in charge were able to solicit more capital in order to improve the corporate infrastructure, but were not able to obtain sufficient funds to rebuild the old and tired store network.[19] Nevertheless, over time, the Board and CEO were able to substantially improve to the corporate infrastructure, making cosmetic (and cheap) changes to the store network as well, as much as their funds would permit.[20]

One of the first and most significant problems the LCBO's new management team faced was the quality and quantity (or lack thereof) of staff. By the mid-1980s, the LCBO was grossly overstaffed (due primarily to patronage appointments). Store employees were mostly older men who were not trained (or encouraged) to provide customers with high levels of product knowledge or customer service. As a result of this, and with an eye to hiring new staff that would better fit the LCBO's new business model, many of these employees were made redundant and released with very generous severance packages.[21] The union, interestingly, after a brief period of confrontation, accepted these redundancies. It also supported the reformation of the LCBO generally. The union recognized that the work LCBO employees had done in the past had been simplified with the introduction of new computer technology to store operations. It saw this trend as possibly endangering the staff's relatively high wages. Accordingly, the union ardently supported a management initiative to train employees with respect to the concepts of alcohol and social responsibility. It was also supportive of training programs designed to develop employees' product knowledge. The union saw both types of training as mechanism that would allow its members to learn new skills, thereby (hopefully) preserving high paying jobs for them.[22] The union also accepted more flexible collective agreements. This paved the way for the hiring of more women, part-timers, youths and those with specific product knowledge.

Another important change was the expansion of the agency store network in the late 1980s. Agency stores had been in northern Ontario since the 1960s, but a program to bring such to rural southern Ontario was launched in the 1980s as part of the overall change initiative. Agency stores are essentially stores that sell other products (i.e. such as general stores), but which have been granted special licenses to sell beverage alcohol (purchased from the LCBO) in communities where full-service LCBO stores are not economically feasible. While only selling a small proportion of the LCBO's products (2%), the expansion of the agency store network was an important development because it helped to quell calls for fundamental change to the liquor distribution system from

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[18] Gee, Larry. Interview, December 20, 2005.
[19] Ibid. Note: The LCBO self-finances its capital outlays by retaining moneys that would otherwise go to the provincial government. The decision to allow the LCBO to retain part of the money it earns is one that lies with the LCBO's political masters.
[20] Ibid.
[21] Ibid. The government was quite sensitive to this issue. It insisted that employees who were made redundant be treated fairly and given generous early retirement packages. Not only were of the employees who were subsequently let go patronage appointments, but a large number, it is suspected by the author, were aging war veterans who had been given jobs at the LCBO upon their return from active service.
[22] Nielson, Heino, Executive Assistant to the President, OPSEU, Interview, November 17, 2005. Note: The Ontario Liquor Boards Employees' Union merged with OPSEU in the summer of 2005 and now is a division of its parent.

under-serviced rural areas. The expansion was also an attempt to help small, rural centers (with economies and populations in decline) increase local sales in stores. If people could purchase alcohol locally, it was surmised that they might also purchase other goods and services at the same time, thus helping to support the local economy. The agency store expansion program was relatively successful in achieving its goals, and addressed a concern of particular importance to the Conservative Party, which had many rural constituents.[23]

While the new board and upper management had assumed power on condition that the government would not interfere in the LCBO's day-to-day operations, the government was still necessarily involved in operations to a certain extent because any new retail developments at the LCBO (like the introduction of refrigerators into stores, accepting payments by credit card, Sunday openings etc.) required governmental approval. Such changes also had to be introduced in a careful, incremental manner; because the government did not want any public backlash to result from them.

Introducing refrigerators into stores serves as a good example of such incremental, careful improvement. In the early 1990s, the LCBO wanted to introduce refrigerators into their stores. This idea was brought to the government by the CEO, Andrew Brandt. A few months later, the government approved a pilot project. The LCBO accordingly introduced refrigerators in a dozen Ottawa area stores (it always used Ottawa for pilot projects, as its close proximity to Quebec meant that its population took a more liberal approach to alcohol) and hired an external polling company to survey customers who chose refrigerated products. The pilot project yielded positive results, and information respecting increased sales figures attributable to the project were subsequently provided to the government. Satisfied that no public backlash would result, and that the refrigeration of products would increase business at LCBO stores, the government formally approved the introduction of refrigerators to the entire store network. However, it is important to note that the publicized rationale for the fridges was not increased sales, but improved customer service and convenience, since the government did not want to be criticized for being seen to be pushing more alcohol. A similar pattern was followed when the LCBO requested government permission to introduce other innovations into its stores. The important points revealed by this example is that the Ontario government, even in the 1990s, was very conscious of public reaction to changes to the LCBO; that, as a result, what appear on the surface to be simple suggested improvements took a significant amount of time and energy to implement; and, more interestingly, that the LCBO took an active and very strategic approach in its (successful) efforts to improve consumer appeal.[24]

In February of 1991, then Premier Bob Rae appointed Mr. Andrew Brandt as CEO of the LCBO, and gave him explicit instructions to improve its financial performance.[25] Mr. Brandt was a former businessman from Sarnia, Ontario who had spent the previous twenty years in municipal and provincial politics. Towards the end of his political career, Mr. Brandt had been a cabinet minister. He was also leader of the

[23] Brandt, Andrew, Interview, November 8, 2005. Information for entire paragraph was derived from this source.
[24] Gee, Larry. Interview, December 20, 2005. Information for entire paragraph was derived from this source.
[25] Brandt, Andrew, Interview, November 8, 2005.

Conservative Party from 1987 to 1991. His appointment was very significant, because he was responsible for steering the LCBO through the early years of its 'modernization' program. Mr. Brandt is a very capable leader who has excellent management and people skills. He is also, more importantly, very politically astute.[26] As a result of his knowledge and skills, as well as ability to 'read' politicians and make arguments that respond to their concerns, Mr. Brandt was able to appeal to a wide diversity of stakeholders during his tenure as CEO while still addressing the large and varied range of needs of the LCBO's political masters.[27] Mr. Brandt's political skills are a major reason why the LCBO has, to date, not been privatized and remains in public hands. His political skills are also, to a great extent, responsible for the LCBO's successful efforts to modernize.

By 1995, the LCBO had implemented a whole host of new programs and policies designed to improve its organization, distribution systems and the retail experience of customers (initiating, for example, uniform signage throughout its store network). It had hired a specialty public relations firm to redesign its stores, signage and general image and had improved staff composition and knowledge by implementing training programs dealing with subjects like product knowledge and social responsibility. However, more fundamental change was impossible, since the LCBO did not have sufficient capital to rebuild the store network.[28] The decision to make capital investments is one that lies outside of the LCBO organization: it lies with its political masters. The necessary capital for fundamental change was - somewhat ironically – finally made available after Mike Harris's Tories were elected in 1995.[29] While, during his election campaign, Mike Harris held a press conference on the steps of the LCBO, asserting that, if elected, the government would sell it off, letting the free market distribute beverage alcohol to the citizens of Ontario, this rhetoric was not backed up by action. In fact, no government did as much as the Harris Tories to improve the LCBO.

The decision to invest money in the LCBO was based on the idea the LCBO was an undercapitalized asset and that increased capital investment would reap significant dividends for the government. For the Tories, who were fighting a mounting deficit, embarked on significant initiatives to reduce or cut government expenditures, and had made election promises to reduce taxes, the prospect of a new, invigorated LCBO, carrying with it the possibility of substantially increased government revenues, was an attractive one. Furthermore, the party's emphasis on law-and-order, and a desire or need on the part of some MPPs to support Ontario wine producers (key stakeholders), meant that significant factions within the Conservative Party still supported public ownership and distribution of alcohol.[30] While the public health arguments (the need to exercise government control over alcohol distribution) and stakeholder support arguments were valid ones, such arguments and rationales were, it is felt, secondary. The main reason why a decision was made to keep the LBO in public hands was the LCBO's significant revenue generating capacity. Additionally, selling-off the LCBO was not a politically

[26] Diamond, Stephen. Member of the Board, LCBO, Interview, December 13, 2005.
[27] Brown, Duncan, former head of the Liquor Licensing Board of Ontario, current CEO, Ontario Lottery and Gaming Commission, Interview, December 19, 2005 and David Lindsay, Former Chief of Staff, Premier's Office, Interview, December 15, 2005.
[28] Brandt, Andrew and Peter, Bob, COO, LCBO, Interviews, November 8, 2005.
[29] O'Brien, Barry, Interview, November 3, 2005 and Brandt, Andrew, Interview, November 8, 2005.
[30] Tsubouchi, David, Interview, October 12, 2005.

viable solution: the money obtained by selling the asset would not compensate adequately for the political costs inherent in doing so. Sale was also a low priority for the Tory government, given their aggressive agenda for change in other arenas.[31] Furthermore, there were concerns that the sale of this undervalued asset with great revenue earning potential to the private sector might lead to considerable political embarrassment for the government, if it were revitalized by private actors after sale.[32] Finally, the current system was (and still is) supported by *most* producer actors, the public health community, the LCBO's union and, most importantly, by the general public. (These points will be further elucidated later in this essay.)

Starting in 1996/1997 the LCBO was permitted to retain $250 million of its earnings in order to make capital investments over five years in what is referred to as a 'seamless capital plan.' A seamless capital plan allows for variable annual capital investments, as long as the total, over five years, does not exceed the stipulated amount. This flexibility was essential for the LCBO, since it wanted to make a number of real estate purchases and investments perforce requiring large, one-time expenditures in order to secure valuable retail spaces.[33] Its ability to retain some of its earnings for its own use meant that the LCBO could finally proceed with plans for major store renovations and relocations and other efforts to improve its image. Now in its second five-year plan, the LCBO continues to spend well over $50 million per year on capital improvements to its store and distribution infrastructure.[34]

These capital investments are not trivial. Nor are they, in the words of an ardent critic of the LCBO, a simple attempt on the part of this institution to build the "Taj Mahal of booze."[35] Rather, these investments play a very specific role in the LCBO's 'modernization' plan, a plan designed to change how people perceive drinking, among other things. For example, in addition to beautifying its store network and improving its marketing strategy, the LCBO has, in recent years, begun publishing its very popular magazine, Food and Drink, started conducting cooking and alcohol tasting classes, and has increased its selection of (and successfully selling) imported and expensive wines. It has also explicitly targeted female consumers. Finally, it has been consistently *promoting responsible drinking.* By taking such steps, the LCBO has been attempting to change how citizens view the consumption of beverage alcohol. Drinking alcohol is no longer a 'sinful' indulgence but is instead viewed as a normal part of a middle-class, healthy lifestyle.

Charged with both increasing revenues to the province and in promoting socially responsible drinking, the LCBO has consciously tried (and succeeded in its efforts) to increase the *value* of the products purchased. Higher value products, particularly spirits, provide much more revenue to the LCBO than lower value brands. This is the only way it could increase revenues without perceived as pushing alcohol onto citizens.[36] The LCBO has, in short, 'up-sold' its customers, encouraging them through marketing, product placement and other means to purchase higher value products. This, in turn, helps the

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[31] Giorno, Guy, Interview, November 29, 2005.
[32] O'Brien, Barry, Interview, November 3, 2005.
[33] Brandt, Andrew and Peter, Bob, Interviews, November 8, 2005.
[34] LCBO, Annual Report, 2003-2004, p. 16.
[35] Menzies, David , *Booze Binge: A Taxpayer-Funded Spending Spree on Palatial New Liquor Stores Raises Questions about Ontario's Priorities* in Canadian Business, June 10, 2002.
[36] O'Brien, Barry, Interview, November 3, 2005.

LCBO to return more money to provincial government coffers. Not surprisingly, the high quality of the LCBO's retail environment and its push to 'bourgeoisify' alcohol consumption are both seen as positive developments by many of its suppliers, who want to sell higher value (and thus more profitable) products, and now view LCBO stores as a mechanism through which they can do so.[37]

The stage has been set. As the above historical overview demonstrates, the LCBO of today is a remarkable institution, one that has completely rebuilt its image, operations and function. The following section of the paper will look at some of the important variables which have come together to help create and shape this outcome.

Revenue:

The large (and growing) stream of revenue that the LCBO provides to government of Ontario is the most significant factor influencing the changes that have occurred at the LCBO in recent years. It is the main reason why the LCBO has not, to date, been sold off and why various Ontario provincial governments, since the time of the Harris Tories, have been willing to invest significant amounts of capital in it.[38] To illustrate the amount of revenue generated by this institution, in 2004/2005, the LCBO handed over $1.115 billion to the provincial government sales on of $3.53 billion (which equates to a 31.56% 'profit' on its sales) – an extraordinary sum.[39] The profit margins that the LCBO charges on its products are set by the provincial government and are not flexible (except perhaps upwards). This 'profit' is comprised of three separate streams and the LCBO does not delineate between the composition of the moneys it hands over to the government. How much of each component that contributes to this 'profit' is an extremely contentious issue and, unsurprisingly, is dependent on one's political and ideological orientation.

The first component or source of LCBO revenue is an operating profit. This is the income left over after all fixed and variable costs have been covered (much like any other business). The second component consists of a 'sin' tax charged on alcohol. This part, like the operating profit, is a part of the margin that the LCBO charges on its products. The third part is a monopoly rent.[40] This amount reflects the under-servicing of the market due to the LCBO's exclusive market position (nobody who is not already in Ontario's liquor distribution market can enter it) and, for example, includes the increased transportation and time costs that are passed onto consumers who must travel farther to acquire beverage alcohol. It also includes the value of centralized marketing (promotion), distribution and administration processes and structures. Perhaps most importantly, however, this amount takes into account the purchasing power of the LCBO; its ability to negotiate good prices with its suppliers, many of whom are large, multinational purveys

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[37] Westcott, Jan, Executive Director, Canadian Association of Canadian Distillers (Spirits Canada), Interview, November 10, 2005 and Heaps, Cam, President, Steam Whistle Brewing, Interview, October 25, 2005.
[38] Tsubouchi, David,, Interview, October 12, 2005; Brandt, Andrew, Interview, November 8, 2005; Giorno, Guy, Interview, November 29, 2005.
[39] LCBO, Annual Report, 2004-2005 p. 28 and p. 29. Calculations by author.
[40] The LCBO is not a monopoly per se, but rather a dominant player in the retail beverage alcohol industry. The term 'monopoly rent' in this context is a term used to describe an actor who operates in an oligopoly and thus does not face perfect competition.

of beverage alcohol.[41] The monopoly-rent portion of the LCBO's profit is often emphasized by those in power at the LCBO when communicating with the government, particularly when the subject of privatization comes up, or when those in charge of the LCBO are attempting to forestall any type of radical market change that would be disadvantageous to it. As the monopoly rent portion of the LCBO's revenue has, in practice, generated high returns for the government, such points tend to resonate with the LCBO's political masters.[42]

Increasing government revenue was particularly important to the Harris Tories who were elected during a time of economic stagnation and budgetary deficits, and who promised to cut taxes and government in their "Common Sense Revolution" policy platform.[43] Alcohol revenues as a percentage contribution to the provincial budget might have been viewed as an under exploited source of revenue for the government.[44] The LCBO's revenues, for instance in 2004, represented 1.3% of the provincial budget, in comparison with 1967-68 fiscal year where income from the LCBO accounted for 7% of government's revenue.[45] As the 'profit' generated by the LCBO lacks the appearance (and indeed is not strictly or wholly) an overt tax on alcohol, but is rather passed on to the provincial government in the form of a dividend from a Crown corporation. It is reasonable to presume that a government could decide to set higher profit margins for the LCBO and reap the benefits of additional revenue, while avoiding paying the political price that would ensue if it had to raise taxes. The LCBO's new sophisticated image, emphasis on higher, more profitable products, high levels of consumer satisfaction and its general improved efficiency, add to its profit as well. These factors also help to further insulate the government's revenue earned from the LCBO from critical scrutiny. The revenue generation capacities of the LCBO both now, and in the future, are thus

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[41] While the LCBO is a very large purchaser of beverage alcohol and accordingly, has significant bargaining power, it is important to note that LCBO does not overly exploit its market position (particularly when dealing with smaller, Ontario-based producers). This is because there is a general ethos of 'cooperation' within the LCBO and, more importantly, because there are external political limitations placed on it. One can compare the LCBO's relationship with smaller producers to its relationship with its unionized workers. As stated earlier in this paper, the LCBO and the union have had a relatively non-contentions relationship, and, as a result, the LCBO has for the most part gotten along well with its unionized labour. The LCBO, in short, could be much tougher than it is, were it not for the political pressures it faces and its own corporate attitude. It could, under a different operating ethos, come to resemble market actors such as Wal-Mart, should those in charge of the institution or the government make different choices. Heaps, Cam, Interview, October 24, 2005; Davidson, Rod, Vice President, Sales, Colio Estate Wines, Interview, November 2, 2005; Brandt, Andrew, Interview, November 8, 2005; O'Brien, Barry, Interview, November 3, 2005.

[42] Giorno, Guy, Interview, November 29, 2005.

[43] Tsubouchi, David, Interview, Oct. 12, 2005. Some insights into the context of the Harris government's electoral victory and subsequent changes to government, see: White, Graham *Revolutionary Change in the Ontario Public Service* in Government Restructuring and Career Public Services, Evert Lindquist, Editor, (Toronto: IPAC, 2000) and Cameron, David R. and Graham White Cycling into Saigon: The Conservative Transition in Ontario (Vancouver: University of British Columbia Press, 2000).

[44] Lindsay, David, Interview, Dec. 15, 2005.

[45] LCBO handed over $1.04 billion to the province in 2004 and the budget for that year was approximately $78 billion. LCBO, Annual Report, 2003-2004 and Ministry of Finance, Ontario, Annual Report and Consolidated Financial Statements, 2004-2005 available at: http://www.fin.gov.on.ca/english/economy/paccts/2005/05_ar.html and Canadian Tax Foundation Provincial Finances 1967 (Toronto: Canadian Tax Foundation, 1967) p.17.

extremely important, and, as a factor influencing how the LCBO has changed in recent years and the decision to keep the LCBO in public hands, should likely be given a weight of 9.5 on a scale of 1 (least important) to 10 (most important).

Other Retailers of Beverage Alcohol:

The Ontario beverage alcohol retail market is, in essence an oligopoly, containing three main types of market actors. In 2005 it was divided up as follows: LCBO (48.6.8% of market by value of gross sales); Brewers Retail (31.3%); and Wine stores (2.5%).[46] The rest of the market (11.0%) is comprised of duty-free liquor outlets, distillery and brewery production sites and homemade products, and the illegal market (6.6%).[47] The Brewers Retail is owned and operated by Labatts, Molson and Sleemans (who has a 1% share). The vast majority of Ontario's wine stores are owned by two companies, Vincor and Andres.[48] While there is competition between these market actors and the LCBO and, at present, intense animosity between the Brewers Retail and the LCBO (largely because the LCBO is increasing its share of the beer market at the expense of the Brewers), there is a symbiotic relationship between all three sets of actors; if the LCBO is privatized, the other two will lose their privileged market positions. The closed nature of the Ontario market means that the right to operate a retail outlet is highly coveted, not only because one can earn significant profits through retail operations, but also because it gives the producers direct access to consumers. For example, while the Brewers carry a wide range of beers (access to the Brewers network is relatively open), they have designed their stores so that each product gets an equal amount of 'shelf-space.' This type of store configuration naturally favours brands with higher advertising exposure and more product lines (that is, beer sold by Labatts and Molsons). The wine stores are restricted to selling Ontario wine products and usually they confine their selection to their own brands. Products that the wine stores sell directly to consumers are subject to a mere 2% markup, in contrast to the 58% margin that the LCBO charges at their stores.[49] Considering that retail prices are uniform throughout the province, this represents a significant difference in profit for the Ontario producers. This arrangement also means that the wineries tend to reserve their highest value and most popular brands for there own stores, rather than selling to them to the LCBO. It is worth noting that other beverage alcohol suppliers who have attempted to limit shipments to the LCBO in an attempt to access and sell in other (more lucrative) markets have met with rebuke from the LCBO.

The point of all the foregoing, however, is that the Ontario wine industry and especially the brewers have impressive, well-funded and well-connected lobbying capacities, and their symbiotic relationship with the LCBO means that they will (and do) use their lobbying skills to ensure that the current system is not significantly altered (i.e.

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[46] LCBO, Annual Report, 2004-2005 p. 32.
[47] LCBO, Annual Report, 2004-2005 p.32.
[48] Between them, Vincor International Inc. and Andres Wines Ltd. operate 290 of the 390 Ontario wine stores. To provide some perspective on their dominance of this portion of the Ontario liquor distribution market, the next biggest winery, Colio Estates, operates 14 stores. Each winery is allowed one onsite retail store and all stores are only permitted to sell the owner's products. Strategy for Transforming Ontario's Beverage Alcohol System: A Report of the Beverage Alcohol System Review Panel (Toronto: Government of Ontario, July 2005) Available at: http://www.fin.gov.on.ca/english/consultations/basr/report.html p. 48
[49] Brandt, Andrew, Interview, Nov. 8, 2005.

the LCBO is not privatized). This factor (the current composition of the Ontario liquor distribution market) represents the second most important reason why the Ontario market has not been significantly altered and why the LCBO maintains its dominant position. On our scale, this factor is should receive an 8.

Ontario Wineries:

The LCBO is used as a vehicle to support the Ontario wine industry. The Ontario government is eager to support this industry as it provides significant number of jobs and is part of a growing eco-tourism industry in the province's wine growing regions. In the late 1980s, the Ontario government, as a result of a WTO ruling, was forced to change its protectionist pricing policy with respect to foreign wines. It could no longer overtly favour its own indigenous products over foreign ones by charging more for the latter. In the wake of this ruling, the government shifted its focus to provide indirect 'subsidies' to the Ontario producers, many of which are provided by or through the LCBO. These indirect subsidies include: providing Ontario producers with preferential shelf space and placing these wines at the front of stores; initiating special promotional programs; and, as discussed, allowing Ontario wine producers to retain their most valuable and popular products for sale in their own stores. The LCBO has also instituted slightly higher profit margins (64%) on foreign wines. The LCBO defends the difference in margins by arguing that foreign wines cost more to bring to the Ontario market than those produced in Ontario, primarily as a result of shipping costs (the LCBO purchases its foreign products in the countries that produce them and then must ship them to Ontario). However, the LCBO must constantly defend this slight difference against criticisms from the federal government.[50]

With respect to Ontario wineries and their relationship with the LCBO, a few important points need to be addressed. First, the vast majority of the Ontario wine sales come from a few large Ontario firms. This causes some members of the Ontario wine industry to feel resentment (smaller producers have difficulty accessing the LCBO's supply chain). LCBO management has attempted to address this concern by establishing an arms length committee that rates potential products for distribution, but in recent years, there has been significant growth in the number of wine producers in Ontario, and there is simply a limited amount of shelf space at the LCBO. An additional complication or difficultly the LCBO encounters with respect to giving shelf space to smaller producers is that many of them do not have the corporate or manufacturing capacities to meet the enormous needs of the LCBO.[51] Finally, it is often difficult to tell whether the criticisms leveled at the LCBO by smaller Ontario wine producers are complaints specific to the LCBO and how it conducts itself or complaints in response to trend towards (and difficulties created by) globalization and industrialization of the wine industry more generally.[52]

The Ontario market, despite its flaws, is much more open to foreign wines than many other retail markets. Try, for example, finding an Ontario wine in California, Italy

[50] Brandt, Andrew. Interview, November 8, 2005. Information for entire paragraph was derived from this source.
[51] Brandt, Andrew. Interview, November 8, 2005.
[52] Paterson, Larry. Former LCBO employee, Interview by phone, Nov. 21, 2005.

or France. Each of these countries has an elaborate system of distribution that effectively bars Ontario producers from entering their marketplace.[53] This fact, in the eyes of the Ontario producers, justifies the preferential treatment they receive from the LCBO. The LCBO must also balance slightly conflicting mandates: revenue generation and promoting Ontario products. For example, according to some suppliers of spirits, the LCBO should allocate more valuable shelf space to suppliers (like them) that can earn the LCBO significantly more income from sales. Yet it is constrained from doing so because it must, as a matter of politics, promote Ontario wines. This is only one of the many conflicts between varied objectives that the LCBO must manage.

The Ontario wine producers are a very powerful, well-connected group that benefits from the fact that the LCBO is a public institution, and as such, amenable to pressure from politicians and the government, who are, in turn susceptible to lobbying from the wine industry. Accordingly, these producers have added their voice to those of others in petitioning the government to preserve the status quo with respect to Ontario's liquor distribution system and refrain from privatizing the LCBO. Big changes to the current distribution system could cause these producers to lose their privileged status with the LCBO and their own retail locations. The power demonstrated by and interests of the Ontario wine producers therefore represent the third most important reason why the LCBO has not been privatized, and continues to modernize and expand. In terms of our rating scale, this factor should receive a 7.

Suppliers to the LCBO:

With the exception of various small wineries and brewers that do not have access to the LCBO store network, suppliers of products to the LCBO are generally pleased with their current arrangements with it. Most suppliers indicate that once you have secured self-space in LCBO stores and have established a functioning relationship with the institution, it is a very good organization in which to do business.[54] The LCBO has a vast store network (approximately 600), a very effective promotions system and a unified distribution and administration network. Its cheques always clear. Unlike Alberta and Quebec, where much of the retail network is in private hands, there is no need to solicit individual store owners for prime shelf space or, in the case of Quebec, to distribute the products yourself. As a result, suppliers are not required to spend as much money marketing and distributing their products in Ontario as they are in some other regions in Canada. In addition, the LCBO's recent decision to focus on increasing high value products in their stores (and the 'bourgeoisification" of alcohol consumption, more generally) has been favourably received by suppliers.[55] They, too, want to sell higher value products as higher value products unsurprisingly mean higher profits.[56] With respect to its influence on preserving the current status quo at the LCBO, this factor should be given a 5.

[53] Franklin, Linda, President, Wine Council of Ontario, Phone Interview, December 5, 2005.
[54] Westcott, Jan, Interview, November 10, 2005; Cam Heaps, Interview, October 25, 2005; Rod Davidson, Interview, November 2, 2005.
[55]Westcott, Jan, Interview, November 10, 2005; Cam Heaps, Interview, October 25, 2005;
[56] Westcott, Jan, Interview, November 10, 2005

Public Health Concerns:

There have been many public debates with respect to how much effect (if any) the retail mechanism chosen by a province to distribute alcohol has on the level of alcohol consumption. This is a very, very contentions issue and there is credible evidence to support each side.[57] The debate on this subject is relevant to this dissertation only from the perspective of how this debate and the positions taken on this issue have influenced decisions made at the political level to privatize alcohol distribution or to keep it in state hands. By and large, the public health sector in Ontario supports a government owned distribution mechanism and is hostile to the idea of increasing the role of the market in alcohol distribution. These health sector actors are quite well organized and have strong internal links. In addition to pressure from the public health sector, there is also pressure from politicians to control alcohol through government distribution. The LCBO, as discussed above, is serious about the control aspect of its mandate, and is dedicated to providing alcohol in a socially responsible manner.[58] The LCBO has often emphasized this point to support its arguments that the LCBO should remain a publicly owned institution and that its current retail structure should be retained. In terms of weight of importance, this factor should be given a 3.5.

All the other factors…….

The LCBO remains a public institution primarily because of LCBO's enormous revenue generation capacity and the other key variables mentioned above. These factors are also the reason why the LCBO's push to improve its infrastructure, service and products has been well received by both the public and industry actors. However, the LCBO's success in altering how it serves the public, and once having done so, maintaining the status quo, is also a byproduct of some interesting partisan politics, serendipity, and the institution's ability to successfully adapt to the needs of its political masters. But just for argument's sake, let's imagine a government wanted to significantly change the alcohol retailing system in Ontario by privatization, for example. Should it choose to do so, that government would face a number of difficult political problems. It would first have to figure out what to do with the LCBO retail and wholesale network. Should it be sold off or franchised? Should some stores be retained or should they all be closed down? How do you explain those now stranded assets? How are you going to structure this new market? Whose interests do you privilege? Then, the government would have to address the concerns of the Ontario wine industry regarding the potential

[57] Giesbrecht et al., p. 201. These authors argue that there is a causative relationship between the form of the distribution system (public monopoly-type versus private market mechanism) and the resultant social costs associated with alcohol usage. Principally, they argue that monopoly-type structures are best able to resist calls to increase availability, stores hours etc. that will have a positive influence on demand (and thus increase the social costs from alcohol consumption). Other researchers, however, dispute that private market mechanisms lead to more problems associated with alcohol usage. Edward Swaka, Director of Research Coordination, Alberta Alcohol and Drug Abuse Commission (AADAC), Interview by phone, March 1, 2006.

[58] Murie, Andrew, Interview, November 30, 2005. Much of the information in paragraph came from interview.

loss of its privileged position under the new system. And what about the private wine stores? The owners of these stores have invested capital in them under the assumption that their rights were relatively secure. Is it fair to change the rules on them mid-stream? And then there are the Brewers. What are you going to do with their 430 store network and wholesale operations? Are you going to compensate two large *foreign-owned* breweries for their losses? (A current estimate of the value of their distribution network is approximately $4 billion).[59] The government would also likely face an outcry from the LCBO's union and relatively influential public health organizations such as MADD. Another factor to consider is the impact the decision would have on the LCBO's customers, many of whom have adjusted to the 'new' LCBO and quite like it. In addition, the government would have to face the possibility that by privatizing, its revenue would go down. No government wants that. It may be that in choosing to privatize the LCBO, the government would be wasting valuable political capital on a "problem people didn't even know they had."[60] After weighing all of the above factors, the government might well conclude that it has more pressing concerns to address than changing Ontario's liquor distribution system. When viewed in this light, it seems as if the decision actually made by successive Ontario governments to retain the LCBO in public hands and to reform and revitalize it was actually a decision to take the path of *least* resistance.

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