A Profitable Brew

A Financial Analysis of the SLGA and Its Potential Privatization

by David Campanella

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A Profitable Brew:
A Financial Analysis of the SLGA and Its Potential Privatization

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Introduction

Privatizing the Saskatchewan Liquor and Gaming Authority's (SLGA) liquor retailing has once again been put on the political agenda. In June 2014, the Premier, Brad Wall, publicly declared that "[t]he old public store-only option is not sitting [well] with Saskatchewan people," and that "people are really interested in new stores being private or all stores being private."[1] Wall went on to say that he would consider campaigning on the issue in the next provincial election. If successful, this would provide the government the legal authority required by the Crown Corporation Protection Act to sell the Crown assets.[2]

The Premier's musings about selling the SLGA's retail stores to private industry is certainly not idle talk. Since coming to power in the 2007 election, Wall's government has sold off several government enterprises and generally divested itself from various parts of the provincial economy. This approach has been applied to the SLGA as well. In 2008, shortly after the Saskatchewan Party formed government, two privately-owned wine stores were allowed to open in Regina and Saskatoon.[3] In 2012, the SLGA was forbidden from opening new retail stores.[4] Licenses were then awarded to major food retailers to open three liquor stores that could carry a full selection of products comparable to an SLGA store.[5] In April 2014, the SLGA closed four rural stores, which has left the Crown Corporation with the smallest network of stores in at least two decades.[6]

Premier Brad Wall visits new private liquor store in Saskatoon.

Turning liquor retailing over to private industry clearly fits the ideological predilections of the current government. The Saskatchewan Party is committed to the idea that economic decisions should be made by private industry, not public institutions. There would appear to be little room for publicly-owned enterprises in the government's vision for economic growth in the province. But would such a move be financially wise for the province? The notion that private retailers will be more effective at producing revenue for the government and that the public will be financially better off in the long run is hardly a foregone conclusion. With over $600 million worth of liquor sold in the province every year and upwards of $250 million in public revenue generated annually, the decision is too important to be made on the basis of ideology.

The following report assesses the financial merits of the proposal for a full or partial privatization of the province's publicly-owned liquor retail business. To do so, key financial metrics of Saskatchewan's liquor operations are compared to those of other western provinces where liquor retailing is done by private industry (Alberta), both private and public entities (British Columbia), and a government agency (Manitoba). According to the Premier, part of the promise of selling off the Crown's liquor retail stores in Saskatchewan are the "one-time proceeds" that would be reaped and made available for investment elsewhere.[7] The report therefore attempts to calculate the likely

return the province would receive from selling its liquor retail related assets. The provincial government's current strategy of restricting the SLGA's expansion while supporting an expansion of privately-owned stores is also financially analyzed as it represents a sharp divergence from the Crown Corporation's previous business strategy. Preceding these assessments is a thorough description of the current operations and finances of the SLGA's liquor distribution business.

Social Consequences

Although this report is focused on the financial implications of selling the government-owned liquor retail assets, alcohol's unique status as a commonly consumed intoxicant make it important to at least briefly mention the implications of privatization for public health and social well-being. Alcohol consumption is a major contributing factor to death, disease, and injury.[8] From fetal alcohol spectrum disorder to drunk driving and violent crimes, the social consequences related to the abuse of alcohol are wide ranging and very serious. Reducing the health and social burdens of alcohol has been the objective of numerous policy documents in recent years from public health organizations at the provincial, national, and international level.[9]

According to the World Health Organization's (WHO), the most cost effective measures of reducing alcohol-related harms are population-based and include, in part, regulating the availability, marketing, and pricing of alcohol.[10] Each of these measures is more difficult to implement in a private retail market than one operated by a public agent. Whereas public liquor agencies are generally tasked with balancing revenue generation with public health considerations, as is the SLGA, each private retailer in a market-based system is singularly driven to maximize its profits. The profit-motive means a private retail system tends to make alcohol more easily accessible, as it struggles to limit sales to intoxicated individuals and minors, markets alcoholic beverages more widely, and actively lobbies to weaken liquor taxation. Regulating these built-in tendencies becomes a difficult, costly, and tenuous task for government.

Critically, the social consequences of alcohol abuse are not solely about public well-being. They also have important economic impacts. Namely, alcohol consumption is linked to significant financial burdens on the government, primarily as the costs to address alcohol-linked crime through the justice system and alcohol linked death, disease, and injury through the health system. The latest figures show that alcohol abuse directly cost Canadian governments $7.4 billion in 2002.[11] In a full analysis of the economic consequences of liquor retail privatization, its effect on these costs must be taken into account. While such calculations are beyond the scope of this paper, a sizeable body of academic research shows that various ill effects of alcohol abuse, and thus its social costs, are positively associated with average consumption levels.[12] Therefore, a liquor distribution system that is able to generate the most government revenue from the lowest rate of consumption is financially ideal. In this regard, the SLGA's ability to increase its net income despite a relatively constant rate of consumption is laudable. Alberta's privatized retail system, on the other hand, has only managed to increase government revenue when the decline in revenue per litre of alcohol sold has been compensated for by a rising consumption rate.[13]

Table 1. Liquor Consumption and Profits in Saskatchewan, FY2010-2014[14]

	Consumption (L per capita)	Net Income (000's)
FY2010	6.5	$ 205,293
FY2011	6.3	$ 214,989
FY2012	6.4	$ 218,663
FY2013	6.5	$ 232,215
FY2014	6.3	$ 252,297

Current Liquor System

The Saskatchewan Liquor and Gaming Authority (SLGA) is a provincial Crown Corporation tasked with overseeing the province's liquor and gambling industries. This report focuses strictly on the SLGA's activities regarding alcohol, unless otherwise noted. The SLGA, and by extension Saskatchewan citizens, also have a direct role in the liquor industry by operating the wholesale and retail distribution industry in the province. The key pieces of legislation governing the actions of the SLGA are *The Alcohol Controls Regulations, 2013*, which was recently overhauled, and *The Alcohol and Gaming Regulation Act, 1997*. As is detailed in the following section, retail distribution is primarily done by publicly-owned SLGA stores. These stores are complimented to a small degree by a few other types of retail outlets. Liquor prices are to some extent managed by the SLGA and its markups are one of the key components of final retail prices.

Distribution System

The retail distribution of liquor in Saskatchewan is performed by SLGA stores, rural franchises, off-sale outlets, and since 2009, private retail stores. Overall, the vast majority of liquor sales are handled by SLGA stores. As shown in the table below, roughly 90% of sales in the 2013-14 fiscal year were handled by SLGA stores. These stores sell a full-line of alcohol products and are located across the province in cities and towns. Only 11% of sales went through rural franchises.

The predominance of the SLGA stores in retailing alcohol is important to note because government representatives tend to describe Saskatchewan's liquor retailing system as a "partnership" between public and private actors suggesting that both play equally important roles. For instance, in 2009 when the SLGA first introduced a private wine store, the Minister in charge described Saskatchewan's retail system as a "private-public hybrid."[16] Such a description casts the proposal to allow private, full-selection liquor stores as being less divergent from the status quo. So when the SLGA declared it would no longer open new liquor stores, the Minister responsible told the Legislature that "[w]hat we are doing is any new stores within our province will be privately-owned…not unlike the 185 private businesses that are already retailing alcohol beverages within our province."[17] Similarly, the Premier recently responded to criticism of his privatization idea by saying that "[w]e've had private liquor retailing in sales [sic] in this province for a very, very long time."[18] While it is true that hundreds of businesses have sold liquor in Saskatchewan for years, they have very much been on the margins.

Saskatchewan's sizeable rural population poses a difficulty for the SLGA, as servicing the rural areas is much more costly and less profitable than dense urban areas. In certain circumstances, the SLGA gives pre-established businesses in such communities a discount to stock and sell liquor on their premises on the SLGA's behalf.

Table 2. Liquor Sales by Store Type, 2013-14[15]

FY2014	Wines, Coolers, Spirits (000's)	Beer (000's)	Total (000's)	% of Total
Rural Franchises	$ 36,695	$ 15,595	$ 52,290	11%
SLGA Stores	$ 301,214	$ 119,826	$ 421,040	89%

Empire Hotel Off-Sale in Regina.

This provides the SLGA a low cost means to at least partially extend the benefits of its liquor system to residents in smaller towns where the operation of a stand-alone liquor store may be deemed prohibitively expensive. Rural franchises, commonly referred to as "agency stores," are a typical approach taken in Canada by provincial liquor boards to provide liquor access to some rural residents. As is the case in Saskatchewan, private businesses in rural towns without a full-scale retail store are granted a license to sell liquor from their premise.

A rural franchise must meet several requirements; for instance, they must maintain a minimum selection and must sell at SLGA listed prices.[19] Rural franchises are rewarded by receiving a 15.3% discount on products purchased from the SLGA, and an 8.2% discount on privately distributed beer. This provides rural franchises with an 8-15% profit margin depending on the breakdown of sales, while presumably being cheaper than what it would cost the SLGA to operate a stand-alone store. Previously, rural franchises were only permitted if they were located at least 20 kilometres from an SLGA store or other rural franchise, but this stipulation was relaxed in 2013 and the number of rural franchises is expected to increase in coming years.[20] There are currently around 182 rural franchises in Saskatchewan.[21]

Another component of the liquor retail industry is the "off-sale outlet." Off-sale outlets are businesses where alcohol is produced or served, such as bars, restaurants or brew-pubs, which are given a special license to sell certain products for off-site consumption. The selection offered in this type of retail outlet can widely vary and be quite limited. The array of changes to the province's liquor regulations the government instituted in 2013 included expanding the eligibility for an off-sale to any liquor licensed establishment.[22] The SLGA limits the number of off-sale licences allowed in each municipality on a per capita

basis. There are currently around 445 off-sale outlets, with several more licenses available.

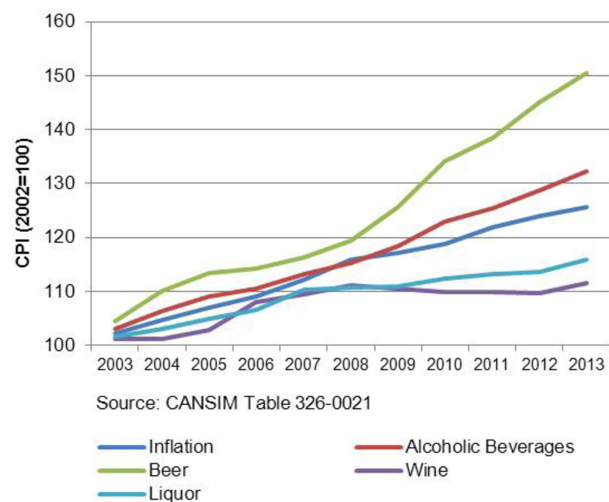
The final part of Saskatchewan's liquor retail system is the recently introduced privately-owned retail store. Two speciality wine stores were licensed in 2009, although one has since been shut down for having illegally bypassed the SLGA to purchase wine. The remaining store, Willow Park Wines and Spirits, purchases its wine through the SLGA. Individuals can similarly special order wine through the SLGA, however Willow Park Wines and Spirits receives a 15.3% discount and is allowed to resell wine by the bottle whereas individuals must purchase wine by the case.[23] Three private, full-selection liquor stores have also been announced. Two of these stores will be owned by the Empire Company (which owns Sobeys), and the other by Saskatoon Co-Op. These stores receive a 16% discount on SLGA markups, and are then able to set their own prices as long as they conform to the province's minimum pricing stipulations.

The wholesale distribution of liquor is controlled by the SLGA. It deals with liquor agents, suppliers, and independent producers to purchase spirits, wine, and beer from around the world. It operates the main liquor distribution centre in the province, located in Regina, and supplies alcohol to its own network of retail stores as well as all the other types of outlets. Beer is imported and distributed by the SLGA as well as private distributors, such as Brewers Distributor Ltd, a private company owned by two of the largest breweries in the world (Molson Coors and Anheuser-Busch InBev). Private distributors are allowed to bypass the SGLA's central distribution channels and manage the importation, warehousing, and/or distribution of their brands. Provincial markups are still applied on privately distributed beer. These are collected by the distributor and refunded to the SLGA, and these companies are audited by the SLGA annually to check compliance. It is not clear what percentage of beer consumed in the province is distributed privately.

Prices

Over the last decade, liquor prices have increased more or less on par with the province's rate of inflation. As evidenced by the figure below, the price of beer has risen much higher than the rate of inflation, while the price of wine and spirits has been lower. The same trend is found in the other three western provinces, meaning it is not specific to a publicly-run distribution system.

Figure 1. Inflation and Retail Liquor Prices in Saskatchewan



The SLGA enforces minimum prices on all liquor products at all retail outlets in the province, including privately run stores. The "social reference price" is based on the type of beverage, the size of the product, and the alcohol content. The minimum prices for certain spirits are further determined by the quality of the product, as organized into three categories — deluxe, premium, and economy. Beer products with high alcohol content (above 6.5%) have an additional surcharge applied based on the alcohol content. The private retail stores, such as those newly opened in the Saskatoon and Regina, are able to set their own prices as long as they are in accordance with the SLGA's minimum prices. Rural franchises are obliged to sell items at SLGA prices, except for speciality items, which the SLGA does not stock and therefore has not set a standard retail price for in its stores.

The SLGA itself maintains price uniformity across all of its retail stores. The same beverage costs the same in Saskatoon as it does in Weyburn, despite the higher costs involved in retailing in remote locations. Combined with uniform prices at all rural franchises, Saskatchewanians know what prices to expect at any liquor store they visit, outside of the few fully private retail stores.

The final retail price of liquor has several components. There is the landed cost, which is the wholesale cost of the product, the base price which includes provincial markups and fees, and the retail price which includes all applicable taxes and fees. The table below details each of these components. Notably absent from the table is private profit. Under a privatized retail system, owners of liquor stores would set retail prices high enough so as to allow them to keep a share of the revenue as profit.

Some of the components listed are quite minor. The three main components of the retail price are the wholesale costs, the SLGA's markup, and provincial and federal taxes. Of these three components, only the wholesale costs and the SLGA's markups are likely to be affected by privatization. Wholesale costs are largely determined by the costs faced by liquor suppliers and liquor agents in selling their products in a particular jurisdiction and the purchasing power of their customers. The global alcohol industry is highly concentrated, with several influential firms dominating the market.[25] In such a scenario, a central purchasing agent can be effective in using its monopolist position to negotiate preferred prices.

SLGA mark-ups are charged as a percentage of the landed costs and vary by beverage type as well as other factors. The basic markup for spirits is 167%, 125% for wine, and 110% for ciders and coolers. Each beverage type and size has a maximum mark-up dollar figure. If spirits or wines are considered premium, based on a landed cost that exceeds a pre-determined amount, the markups are reduced to 44-55%. Mark-ups for beer depend on the production volumes of the brewery. Beers produced by large national or international breweries have a mark-up of $1.993 per litre. Beers produced by smaller breweries have a slightly lower mark-up of $1.843 per litre, while microbrewery beers have a markup of $0.987 per litre. All mark-ups were increased by "approximately three per cent" in the 2013-14 provincial budget.[26]

Table 3. Component Breakdown of Liquor Retail Prices[24]

Price Component	Explanation
Supplier quote	Cost for SLGA to purchase product from supplier
x Exchange rate	If purchased abroad, converts prices to Canadian dollars
+ Federal import duty	Small tax on import products according to origin and beverage type
+ Federal excise tax	Tax based on beverage type and either volume or alcohol content
+ Freight	Rate per litre depending on origin
= Landed cost	
+ SLGA markup	Ad valorem mark-up charged as percentage of landed cost, depending on beverage type and to a maximum for certain types
+ High alcohol surcharge	Flat rate per litre of pure alcohol on alcohol content above 6.5%
+ Cost of service	Fee on import products and SLGA distributed beer based on units per case
+ Environmental surcharge	Fixed fee based on container type and size, ranging from 3-8¢
= Base price	
+ Goods & Services Tax	5% of base price, collected federally
+ Liquor Consumption Tax	10% of base price, collected provincially
+ Container deposit	Refundable deposit based on container type and size, at most 40¢
= Retail price	

Profitability of Current System

The SLGA's current mission is to: "Serv[e] Saskatchewan people with excellence while promoting economic growth through the socially responsible distribution, management, operation, and regulation of liquor and gaming products." Accordingly, the SLGA is tasked with balancing its objectives of generating revenue for the provincial government, selling alcohol in a socially responsible and fair manner, and providing a high-level of customer service. As this report analyzes the SGLA's activities regarding the first objective, it is important to remember that the SLGA's revenue generation are to some degree offset by its actions toward meeting the other two objectives. Unlike private corporations, the SLGA is not legally compelled to solely prioritize maximizing profits. It therefore has the leeway to make decisions that might diminish its profitability but accomplish other objectives. This makes the SLGA's exceptionally high profits that much more remarkable. The following section details these profits, as well as the SLGA's revenues and expenses. The figures deal strictly with the SLGA's liquor operations and do not include the SLGA's gambling-related operations.

Revenue

The SLGA's revenue from liquor sales has continuously increased over the last five fiscal years. These sales figures do not include revenue from the GST, Liquor Consumption Tax (LCT), returns, container deposits, or discounts. From 2010 to 2014, total liquor revenue increased 13%. The increase in sales has predominantly come from spirits, wines, and coolers, which have increased 20% in value. Revenue from beer sales also increased, but grew at a more modest 11%. Spirits, wine, and coolers now constitute 55% of total sales, up from 52% in 2010.

Table 4. Revenue by Beverage Type, 2010-14[27]

Fiscal Year	Spirits, Wine, and Coolers (000's)	Beer (000's)	Total (000's)
2010	$ 281,956	$ 241,115	$ 541,095
2011	$ 291,710	$ 259,139	$ 550,472
2012	$ 305,725	$ 258,762	$ 571,844
2013	$ 324,262	$ 266,119	$ 592,330
2014	$ 337,909	$ 268,068	$ 612,026
% Increase	20%	11%	13%

The volume of beer sold in the province has remained roughly the same over the last five fiscal years, meaning the increase in beer revenue is due to consumers switching to more premium brands. The volume of wine and coolers sold in the province has increased significantly, 25%, which may explain much of the increase in the value of non-beers sales.[28]

Not surprisingly, liquor sales in the province are heavily concentrated in the major cities — Saskatoon and Regina, and to a lesser extent Prince Albert and Moose Jaw. Of the 15 SLGA stores with the highest average sales between fiscal years 2010 and 2014, 13 are located in these four cities. The other two stores are in Yorkton and North Battleford, which are the twelfth and thirteenth highest, respectively. These 15 stores accounted for 60% of liquor sales at all SLGA stores over the last five fiscal years.[29]

Expenses

Any retail business has two main categories of expenses: costs of goods sold (COGS) and operating expenses. The COGS for an integrated liquor distribution system such as the SLGA is the wholesale purchasing of the alcoholic beverages

from the liquor suppliers and their agents. The wholesale cost includes the expenses related to manufacturing and the manufacturer's profit margin, as well as marketing and transportation expenses. The Partnerships and Supply Management Division of the SLGA is responsible for purchasing liquor from around the world. In 2014, the SLGA purchased $295.2 million of liquor. This is up slightly from $272.1 million in 2010. One measure analysts use to compare the input costs of distinct businesses is the gross profit margin. Gross profit is the difference between sales revenue and COGS, while the gross profit margin is the ratio of gross profit to sales revenue.

COGS, sales revenue, and gross profit margin for the SLGA's liquor operations from fiscal years 2010 to 2014 are shown in the table below. Both input costs and revenue have increased over the five years, although revenue (13%) has grown somewhat more than input costs (9%). Accordingly, the gross profit the SLGA earns on liquor sales has increased slightly from 50% to 52%. The SLGA achieves an exceptionally high gross profit margin. Major retail grocers, for instance, have gross profit margins that range from 14% to 36%.[30]

Table 5. Input Cost and Gross Profit Margin, 2010-2014[31]

Fiscal Year	Cost of Liquor (000's)	Total Revenue (000's)	Gross Profit Margin
2010	$ 272,098	$ 544,009	50%
2011	$ 268,929	$ 553,539	52%
2012	$ 282,428	$ 574,714	51%
2013	$ 291,192	$ 595,243	51%
2014	$ 295,246	$ 615,670	52%

Unfortunately, it is impossible to calculate the gross profit margin associated with each type of alcoholic beverage as the SLGA no longer includes the wholesale costs of each beverage type in its annual reports. The liquor board of the neighbouring province of Manitoba, which also has a publicly-run liquor distribution system, does provide such information. Judging from the Manitoba Liquor Control Commission's 2013 figures, gross profit margins are highest for spirits at 61% and lowest for beer at 41%. The gross profit margin on wine and "refreshment beverages" is 54%.[32] Presumably then the increased proportion of liquor sales in Saskatchewan that are from non-beer beverages has been financially beneficial to the SLGA.

Operating expenses related to SLGA's liquor operations were $72.5 million in the 2014 fiscal year. Operating expenses have increased less than 10% over the last five years, and have remained between 13% and 11% of sales revenue. The majority of operating expenses are related to staffing. The other major components are costs associated with building rentals (the SLGA rents, rather than owns, a significant share of its properties), depreciation (an accounting measure used to account for the gradual wear and tear on fixed assets), and professional services (contract work outsourced to non-employees). The specific breakdown of these operating expenses for fiscal years 2010 to 2014 is listed in the table below. The SLGA's annual reports unfortunately do not provide a breakdown of operating expenditures strictly for liquor operations in 2010.

Table 6. Operating Expenses, 2010-2014[33]

Fiscal Year	Salaries and Benefits (000's)	Rent, Utilities and Insurance (000's)	Depreciation (000's)	Professional Services (000's)	Total Operating Expenses (000's)
2010	–	–	–	–	$66,618
2011	$41,423	$6,461	$3,440	$2,243	$69,621
2012	$51,447	$6,408	$3,251	$2,126	$73,623
2013	$44,352	$7,340	$2,869	$3,098	$71,836
2014	$44,404	$6,823	$3,034	$4,799	$72,514

As of March 31, 2014, there were 742 employees working in the SLGA's retail stores. Another 48 staff work in the central distribution warehouse. Most non-management employees are members of the Saskatchewan Government and General Employees Union (SGEU). The average hourly wage earned by full-time retail staff is $22.74 per hour, with part-time clerks earning less and managers earning more. As will be shown below, the SLGA is able to pay its staff these wages while also achieving substantial profits. The SLGA would likely be able to increase its profits by reducing staff wages, but as it is the SLGA is able to earn very high profits while also creating middle-class jobs and being a significant employer in the province.

Overall, the vast majority of the expenses from the SLGA's liquor operations are the wholesale costs. In 2014, fully 80% of the total expenses was the cost of purchasing liquor. The other 20% included the operated expenses related to both the retail stores, the distribution warehouse, and central administration. This is critical to keep in mind in discussions of retail privatization as the costs related to actually operating the retail stores are relatively minor.

Figure 2. Input and Operating Expenses, 2010-2014

Capital Investment

The distribution of liquor is not a capital-intensive operation. Relatively little capital investment is required to maintain sales revenues. The SLGA, for instance, made capital investments of between $1.4 and $3.8 million between 2010 and 2012 in its liquor operations. This is a very low reinvestment rate of just 1-2% of the yearly net income. There was $7.9 million invested in 2013 and $17.3 million invested in 2014. The sharp increase is presumably due to initial payments toward the construction of a new, larger distribution centre.[34] The SLGA expects the 158,000 square foot facility to cost $37 million and be completed in 2015.[35] These are small sums relative to the over $500 million in revenues accrued during each of those years. These investments are easily funded internally through the SLGA's operating income. All business need to reinvest part of their earnings back into their operations in order to sustain themselves. Granted the SLGA is allowed to retain some earnings to invest back into its business, the SLGA's liquor operations do not require the input of any public funds. Even the higher capital investments in recent years represent just 3-7% of yearly net income.

A loan of $125 million was made in 2013 by the Saskatchewan government to the SLGA. According to statements by the Minister responsible for the SLGA before a legislative committee, the loan was almost entirely for its gambling operations: $110 million to completely replace their network of nearly 4,000 video lottery terminals (VLTs) and nearly 3,000 slot machines.[36] A further $14 million was used to replace the IT system, and $1 million was put toward "building and equipment." A breakdown of the $15 million between the liquor and gaming sides of the SLGA is not available. But the SLGA could have easily financed the capital investment itself with its own operating funds, as it has done in the past.[37] Such investments are a standard and necessary business practice.

Net Income

Subtracting the wholesale cost of liquor and operating expenses from the SLGA's liquor-related revenues provides the net income. Liquor revenue here also includes a small amount of income derived from liquor licenses, permits, and fines. Since the 2010 fiscal year, liquor operations have generated upwards of $200 million in profits for the SLGA every year, as shown in the table below. Net income has grown impressively over the last five fiscal years, increasing 23% to over a quarter of a billion dollars by 2014. According to its annual report, the objective of the SLGA is not to achieve a pre-determined profit level, but rather to "promot[e] year-over-year sustainable profitable growth."[38] Judging by the SLGA's 23% growth in net income and the affordability of future capital investments, the SLGA is succeeding in meeting this objective.

Each year, virtually all of the SLGA's net income is transferred to the government. In the last five fiscal years, the SLGA's liquor operations have provided $1.1 billion to the province. It is the Treasury Board who decides when and how much of the SLGA's earnings are transferred to the government.

Table 7. Net Income and Remittance, 2010-2014[39]

Fiscal Year	Net Income (000's)	Remittance (000's)	Retained Earnings (000's)
2010	$ 205,293	$ 205,293	$ 0
2011	$ 214,989	$ 214,989	$ 0
2012	$ 218,663	$ 218,589	$ 74
2013	$ 232,215	$ 232,215	$ 0
2014	$ 252,297	$ 251,596	$ 701
Total	$ 1,123,457	$ 1,122,682	$ 775

These results are especially impressive due to the fact that the increase in net income has not been driven by higher consumption rates among Saskatchewanians. In fact, net income increased significantly in 2011 and 2014, two years which saw a reduction in liquor consumption per capita.

Other Revenue

The SLGA's liquor operations also generate government revenue in ways not accounted for here as they exist regardless of whether the operator is public or private. The Liquor Consumption Tax (LCT) is a 10% sales tax the province levies on the sale of all beer, wine, and spirits. In 2013-2014, the LCT is budgeted to raise $88.8 million for the government, up from $85.8 million in the previous fiscal year. In lieu of property taxes, the SLGA pays grants to the municipalities in which its retail stores operate. With roughly 800 employees and annual salary and benefit expenditures of $44.4 million, liquor retailing is also a significant source of employment in the province. The personal income generated is partially taxed and returned to the province in the form of income tax revenue.

Profitability

According to the SLGA's own measurement, it is a very profitable business. In addition to addressing its other policy objectives, it has managed its resources quite effectively. Marginal return on expenses (MRE) is a measurement used by the SLGA to assess its operational efficiency and success at increasing net income. MRE is calculated by comparing the change in net income to the change in operating expenses, where a positive ratio indicates that net income grew (fell) more (less) than proportionally to the increase (decrease) in operating expenditures. The SLGA unfortunately only includes an MERA assessment of its entire operation, not each of its segments. But measured on an annual basis, the SGLA's entire operation has had a positive MRE almost every year since the 2003-2004 fiscal period. The only two exceptions have been years in which there were temporary reductions in VLT revenues. This shows that when the SLGA has taken on additional operating expenses it has generally had a positive financial outcome for the

province by resulting in a more than proportional increase in net income.

The MRE as used by the SLGA is a useful but limited measurement. One limitation is that it only measures financial changes rather than the overall operations. Hypothetically, a smart decision could improve profitability but a firm may still be unprofitable. Two, the SLGA only included operating expenses in its calculations, which misses changes in by far the biggest expense in liquor retailing: the cost of liquor. Third, the MRE does not provide a straightforward measure of profitability that can be easily compared across different businesses.

Return on investment (ROI) is a more preferable measure of profitability. ROI is a common financial ratio that allows analysts to readily compare the profitability of different companies. It is determined by dividing the profit of an investment by the cost of an investment. Or, in this case, the net income by the expenses. The higher the ROI, the more profits were generated relative to the size of the investment. Calculating the ROI of the SLGA's liquor business means dividing the net income by total expenses (COGS plus operating expenses). The SLGA's liquor-related ROI for the last five fiscal years is displayed in the table below.

Table 8. Return on Investment, 2010-2014[40]

Fiscal Year	Net Income (000's)	Total Expenses (000's)	ROI
2010	$ 205,293	$ 338,716	61%
2011	$ 214,989	$ 338,550	64%
2012	$ 218,663	$ 356,051	61%
2013	$ 232,215	$ 363,028	64%
2014	$ 252,297	$ 367,760	69%
Total	$ 1,123,457	$ 1,764,105	64%

The SLGA's liquor business has been exceptionally profitable for the province. The average ROI over the last five fiscal years has been 64%, with the ROI increasing from 61% in 2010 to 69% in 2014. To put these returns in perspective, between 2009 and 2013 the S&P 500, a commonly used index of the U.S. stock market, achieved average annual returns of 17.9%.[41] This means that if the provincial government had placed the nearly $2 billion the SLGA has spent on liquor distribution over the last five years in major U.S. stocks, it would have received roughly $320 million instead of $1.1 billion.

Returns for the public from operating the distribution of liquor have also been remarkably consistent. Each of the last five fiscal years has seen positive returns of over 60%. As shown by historical S&P 500 data, the returns generated by the ownership of businesses are much more volatile. Over the last forty years, the S&P 500 has had negative annual returns on average one out of every four years.[42] Looking back twenty years (1994-2013), the average annual return of the S&P 500 has been just 9.2%.[43] It is therefore quite rare to find a business investment that provides the exceptionally high and consistent returns as does the SLGA for the citizens of Saskatchewan.

Analysis of SLGA's Current Strategy

Over the last couple of years, the provincial government has gradually unfolded a major change in Saskatchewan's liquor distribution system. Three policy changes in particular illustrate the shift: the Fall 2012 decision to not build any new public liquor stores, the licensing of four full-service liquor stores in Saskatoon and Regina which are slated to open over the next year, and the closing of four SLGA stores in Spring 2014.

So why has the provincial government strictly limited the SLGA's ability to expand its retail liquor network to meet the growing demand? The Minister responsible for the SLGA has claimed that closing the four SLGA stores in rural Saskatchewan and allowing rural franchises to take over liquor retailing in the towns will be a financial gain for the province.[44] The government has been less certain whether allowing fully private liquor stores to compete with the SLGA in urban Saskatchewan is financially prudent. The Minister's statements have instead suggested that the SLGA likely will not lose money on the decision. However, the discussion should be about whether allowing these private stores to open is the best financial decision for Saskatchewan citizens when compared to other options, such as opening new SLGA stores.

The following section will analyze the SLGA's current business strategy of halting its retail expansion, closing rural stores, and allowing competition in urban centres.

Closing Rural SLGA Stores

As a crown corporation, the SLGA has the benefit of not having to strictly focus on maximizing profitability, as is the fiduciary duty of other corporations. The SLGA can also strive to meet other needs, for instance, serving small rural communities even if it is less profitable than operating solely in urban centres. There is little doubt that the selection and service offered by rural franchises, where selling liquor is tacked onto the primary business, is inferior to that of an SLGA store. Moreover, as discussed above, SLGA stores can afford to pay decent wages and benefits to its employees, making these stores an important source of employment in small communities. The four closures has meant the loss of four full-time and eight part-time jobs. Certainly these small rural communities need more well-paying jobs, not less.

Nonetheless, the government's rationale is that the SLGA will reduce its expenses by closing a store if its operating costs are more than the 15.3% of sales it could pay a rural franchise to sell its liquor. During a debate in the Legislature on the closing of the SLGA stores in Ituna, Langenburg, Kerrobert, and Ponteix, the Minister responsible for the SLGA claimed that "the profit margins on these stores is less than the 15.3 per cent discount which is offered to franchises. Mr. Speaker, it is a cost savings business decision that our government has made and it will save us

approximately three-quarters of a million dollars, Mr. Speaker."[45] In 2014, the operating costs of the Langenburg, Ituna, and Ponteix stores were higher as a percentage of sales than the 15.3 per cent discount given to franchises. According to internal SLGA calculations, the operating costs of these three stores were 19.3%, 21.7%, and 28.6%, respectively.[46] The operating costs of the Kerrobert store were 14.75% of its sales revenue, meaning the SLGA would pay a rural franchise more to sell its liquor than it would by continuing to operate its own store. The building in which the Kerrobert store operates is "quickly nearing the end of its useful life," according to Minister Harpauer, and would thus need to be repaired or the store relocated to another site.[47] In this case, the government has decided to close the Kerrobert store at a cost of roughly $5,000 per year instead of allowing the SLGA to make the capital investment necessary to keep the store open.

For the other three rural stores, the potential annual savings targeted by the SLGA from these closures is essentially negligible. As shown in Table 9, the closure would mean annual operating expenses of $297,205 instead of $435,287. This amounts to potential annual savings for the SLGA of $138,082, or just 0.05% of the SLGA's net income from liquor sales that year. This sum is also significantly less than the $750,000 quoted by the Minister. The key assumption here is that liquor sales remain the same. In 2014, these three stores sold close to $2 million worth of alcohol. If sales decline for instance due to inferior selection, location, or staffing, the potential savings would be even less.

Table 9. Potential Savings from Closing Three Rural Stores[48]

FY2014	Operating Expenses	"Operating Expenses" if Rural Franchise	Possible Savings
Langenburg	$ 150,078	$ 118,851	$ 31,227
Ituna	$ 152,417	$ 107,415	$ 45,002
Ponteix	$ 132,287	$ 70,940	$ 61,852
Total	**$ 435,287**	**$ 297,205**	**$ 138,082**

It is critical to highlight that these four stores had not been costing the SLGA money. That is, each store earned more in sales revenue than it cost the SLGA to stock the shelves and operate the stores. Indeed, these four stores earned the SLGA $4.36 million over the last five fiscal years. The Langenburg, Ituna and Kerrobert stores each netted over a million dollars each over that time period. The store in Ponteix, a town of 600 people and a hub for the wider area, has by far the lowest sales out of the SLGA's entire retail network and is therefore not surprisingly the least profitable store. However, the store generated roughly half a million in profits over the last five fiscal years. The four stores together netted the SLGA roughly a million dollars last fiscal year alone. As such, the government's decision to close the stores is not about unloading costly assets. Rather, it is a chance to minimally increase annual revenues by removing its full-selection stores from four rural communities.

Moreover, the SLGA's spending on these stores has resulted in impressive dividends. Although these are four of the least profitable stores in the SLGA's retail network, they have still netted the SLGA impressive results for the money spent. In the 2014 fiscal year, for instance, it cost the SLGA $1.9 million to stock and operate the four

Table 10. Profits of Closed Rural Stores, 2010-2014[49]

Net Income	FY2010	FY2011	FY2012	FY2013	FY2014	Total
Langenburg	$ 236,133	$ 226,966	$ 249,964	$ 237,684	$ 274,417	$ 1,225,164
Ituna	$ 206,096	$ 224,241	$ 236,232	$ 255,496	$ 228,734	$ 1,150,799
Ponteix	$ 78,529	$ 97,725	$ 89,914	$ 102,538	$ 123,680	$ 492,386
Kerrobert	$ 278,335	$ 262,137	$ 273,024	$ 308,347	$ 369,970	$ 1,491,813
Total	$ 799,093	$ 811,069	$ 849,134	$ 904,065	$ 996,801	$ 4,360,162

stores. That year, the four stores earned $996,801 in profit, resulting in an exceptional return on investment of 53%. If there is any money saved by the closures, it is difficult to imagine the government will be able to find a similar return by investing the money elsewhere.

Table 11. Return on Investment of Closed Rural Stores, 2010-2014[50]

	FY2010	FY2011	FY2012	FY2013	FY2014	Average
Langenburg	49%	50%	51%	46%	55%	50%
Ituna	45%	50%	50%	53%	48%	49%
Ponteix	25%	30%	27%	29%	36%	29%
Kerrobert	52%	56%	55%	60%	66%	58%
Average	43%	46%	46%	47%	51%	47%

Adding Only Private Retail Stores

The government has not presented serious evidence to support their constraining of the SLGA's retail operations. The Minister responsible for the SLGA stated that her agency's decisions to only allow new private liquor stores was based on the view that the government's choice is either a "new liquor store or (a) new school."[51] But a liquor store is a revenue-generating asset, and the SLGA generates more than enough revenue to pay for its own ambitious capital plan. The construction of an SLGA liquor store would not require input of any public tax dollars and as detailed above is likely to provide substantial returns, so such a statement makes little financial sense.

Regardless, the SLGA has announced that four privately-owned liquor stores will be allowed to operate in Saskatchewan. In 2009, the SLGA allowed a stand-alone wine store in both Regina (Willow Park Wines and Spirits) and Saskatoon (Cava Wines and Spirits[52]). Licenses for full-selection liquor stores have since been granted to two major grocery chains: Sobey's and Co-op. Sobey's opened a stand-alone liquor store in Saskatoon in September and will be opening another store in Regina next spring, while Co-Op opened a newly constructed liquor store across from a shopping centre in June, 2014.

SLGA Minister Donna Harpauer announces private liquor stores in Regina.

From a financial position, the government's directive that the SLGA not add any additional retail stores to its network is curious. Saskatoon and Regina are clearly markets that could support additional liquor stores. Between 2001 and 2013, the number of people living in Saskatoon and Regina over the age of 20 increased by 34,917 (24% increase) and 57,778 (35% increase), respectively.[53] Disposable income also increased significantly. Real after-tax median income has increased 23% in Regina and 28% in Saskatoon over the decade ending in 2012.[54] However, the SLGA has not expanded its number of retail store in either city for at least the past 15 years.[55]

The SLGA can also easily afford to open new retail stores. Its annual profits of over $250 million offer more than sufficient capacity to fund an expansion of liquor outlets. According to *The Alcohol and Gaming Regulation Act, 1997*, the Treasury Board determines when and how much of the SLGA's retained earnings are transferred to the provincial government's General Revenue Fund. Over the last five fiscal years, the Treasury Board has left the SLGA with less than 0.1% of its profits. Yet no business can succeed without reinvesting some of its profits back into its operations. If the SLGA was allowed to retain 10% of its annual net income for capital investments,

as is a common business practice, the SLGA would have $25 million a year that it could use to improve and expand its retail operations.

It is far from clear that the government's decision to have the four new liquor stores be privately rather than publicly-owned will be a financial gain for the SLGA. In fact, early calculations based on the data available show the decisions will likely cost the SGLA substantially in foregone revenue. It is too soon to know the exact revenues and expenses of the new private stores, and it is not clear whether such information will at any point be publicly available. But the financial data available for each SLGA store allows for a simple calculation of the likely financial consequences of the new stores being private rather than public.

New stores in the urban areas, whether public or private, are likely to have sales revenue within the range achieved by pre-existing SLGA stores. Since the private liquor stores will be based in Saskatoon and Regina, it is possible to look at the performance of the SLGA stores in these cities as proxies to the likely finances of the private stores. There are nine SLGA liquor stores in Saskatoon and seven in Regina. These stores had a wide range of annual profits in the 2014 fiscal year. The highest grossing SLGA store in these two cities was the Quance Street store in Regina. It had annual revenue of $28.6 million and profits of $13.5 million. The lowest grossing store in either of the cities was the 20th Street West store in Saskatoon, with $2.3 million in sales revenue and $836,770 in profit.

For the private ownership of the new stores to be a financial benefit to the province they would have to provide the SLGA higher net income than a public store would with comparable sales. Based on the above financial figures of current SLGA stores in Regina and Saskatoon, and a generous assumption that private operators will be able to reduce their operating expenses to half of the level in comparable SLGA stores, it is possible to calculate the likely returns for the SGLA from the four private liquor stores. As happened in Alberta when that province privatized its retail liquor stores, private operators are often able to reduce operating costs by replacing well-paying jobs with minimum-wage jobs. But operating expenses also include items such as rent and depreciation that would be similar to what the SLGA would otherwise pay. It is highly unlikely that private stores will have operating expenses that are half what would be the case in a comparable SGLA store.

Private stores currently purchase their liquor from the SLGA at a 16% discount of the SLGA's retail price. For simplicity sake, assuming the private stores carry items at similar prices as the SLGA, their cost of purchasing liquor will therefore be 84% of their sales revenue. Private stores will also pay corporate income tax on their profits, which the SLGA does not do (it remits all of its profits to the province). The general corporate income tax rate in Saskatchewan is 12% for businesses earning more than $500,000 in annual profits. Businesses earning less than this amount pay the small businesses tax rate of 2% of their net income.

Wholesaling liquor to a private retailer, the SLGA's net income is determined by the difference between the price at which the SLGA purchases liquor from producers and their agents (the landed cost) and the price at which it sells to the retailer (the base price). In this scenario, the former is the same as the COGS for

Table 12. Finances of SLGA stores in Saskatoon and Regina, FY2014[56]

Store	Sales	COGS	Operating Expenses	Net Income	ROI
Highest Grossing (Quance St)	$ 28,554,564	$ 12,811,513	$ 2,290,076	$ 13,452,975	89%
Average SLGA store	$ 15,193,069	$ 6,834,587	$ 1,335,616	$ 7,022,866	86%
Lowest Grossing (20th St W)	$ 2,373,390	$ 1,074,815	$ 434,805	$ 863,770	57%

the SLGA comparable. The latter is the COGS for the private retailers.

The first table below estimates the finances of a private retailer based in the major cities, according to the assumptions outlined above and the stores sales revenue matching either the high, average, or low point set by the existing SLGA stores. It shows that if a private retail store is only able to match the sales revenue of the 20th Street West store in Saskatoon, its annual profits will be slightly higher than $150,000. Similarly, a private retail store able to achieve the average sales revenue of the SLGA stores in Regina and Saskatoon would have estimated annual profits of $1.8 million. A private retailer with sales revenue equivalent to the Quance Street SLGA store would under these assumptions have annual profits of nearly $3.5 million.

The financial data in Table 13 allows us to calculate the net income that would accrue to the SLGA under these scenarios, and by comparing it to net income the SLGA currently earns from the operation of these liquor stores itself, we can determine which is more profitable for the SLGA. In other words, we can compare the profits the SLGA might earn as a wholesaler to the profits the SLGA currently earns by acting as a wholesaler and retailer. As can be seen in Table 14, the SLGA stands to earn additional revenue of less than a quarter of a million dollars if each of the four private stores only achieve sales revenue equivalent to the lowest grossing SLGA store in Regina or Saskatoon. If the private stores manage sales revenue higher than this low bar, the SGLA stands to lose substantial income by not operating the retail stores itself. For instance, if the private stores have the average sales revenue of the urban-based SLGA stores, then under the above assumptions the SLGA would forego annual profits of over $3.5 million. In the worst case scenario, of the four private stores achieving the same sales revenue as the Quance Street SLGA store, the SLGA would forego annual profits of nearly $7.5 million. Over the decades that these stores are likely to operate, the losses will accumulate to quite substantial sums. As such, the available financial data indicates that the SLGA would best maximize its profits by owning and operating all new liquor retail stores in the province.

Table 13. Estimated Finances of Private Urban Liquor Stores[57]

Private Stores	Sales	COGS	Operating Expenses	Net Income
High Revenue	$ 28,554,564	$ 23,985,833	$ 1,145,038	$ 3,423,693
Average Revenue	$ 15,193,069	$ 12,762,178	$ 667,808	$ 1,763,083
Low Revenue	$ 2,373,390	$ 1,993,647	$ 217,403	$ 162,340

Table 14. Foregone Revenue from Urban Stores Being Private Rather than Public

	SLGA's Profit as Wholesaler	Income Tax Revenue	SLGA's Total Net Income as Wholesaler	Current SLGA Income as Wholesaler and Retailer	Foregone Revenue Per Store	Total Foregone Revenue Per Year
High Revenue	$ 11,174,321	$ 410,843	$ 11,585,164	$ 13,452,975	-$ 1,867,811	-$ 7,471,244
Average Revenue	$ 5,927,591	$ 211,570	$ 6,139,161	$ 7,022,866	-$ 883,705	-$ 3,534,822
Low Revenue	$ 918,833	$ 3,247	$ 922,079	$ 863,770	$ 58,309	$ 233,238

Full Privatization

In the spring of 2014, Premier Brad Wall made clear that he was considering selling all of the SLGA's liquor retail assets to private industry. After positing in May that Alberta earned more revenue from liquor after it sold off its retail stores, Wall declared in June that "[e]verything is on the table now, from [the] status quo to full privatization."[58] The Premier is not the only one to use Alberta's experience with liquor retail privatization as a justification for Saskatchewan to do the same. Members of the media have similarly boasted about Alberta's fortunes since privatization, and the usual free market ideologues continue to point to Alberta as a story of unmitigated success.[59] Based on such praise from pro-market politicians and pundits, one might expect Alberta's privatized liquor system to provide better financial returns to its citizen's than does the publicly-owned system in Saskatchewan. The following section shows that this is not in fact the case, and explains why. For a complete assessment of the financial implications of fully privatizing liquor sales in Saskatchewan, this section also examines the one-time revenue that might be generated by the sale of the SLGA's assets as well as corporate income tax likely paid by such an industry.

Alberta's Privatized Liquor Distribution System

In 1993, Alberta became the first province in Canada to fully privatize its liquor retail system. More than two decades later, it remains the only province to have done so. British Columbia, Quebec, Ontario, and other provinces, have to some extent allowed private businesses to enter the retail liquor industry. But Alberta is the only province to have no government-owned liquor retail stores.

At the time of Alberta's liquor privatization, the government sought to hinder the large grocery chains from leveraging their control of the food and beverage retail market. The intent was to lower the barriers to entry and encourage a market composed of small businesses. To this end, the government stipulated that individual retailers would not be allowed to negotiate discounted prices with liquor suppliers, in essence limiting the ability of large chains to use their economies of scale in acquiring bulk purchasing discounts. Further, the government mandated that all liquor stores be in a free standing building or physically separated area. Nonetheless, two decades after privatization roughly a third of Alberta's retail stores are part of a large chain. Specifically, about a quarter of the retail stores are owned by five companies: Liquor Stores NA (175), Rocky Mountain Liquor Co (46), Empire Company (53), Loblaws (34), and Calgary Co-op (24).[60]

The Alberta government continues to own the central warehouse in the province. Connect Logistics, a private company, has been contracted by the government to manage the warehouse since privatization began. The Alberta Gaming and Liquor Commission (AGLC), the provincial liquor board, collects revenue from alcohol sales by levying a markup tax at the wholesale level which Connect Logistics collects on its behalf when it sells the liquor to individual retailers. Unlike the SLGA's ad valorem markup system (a percentage markup of the landed cost), following privatization the AGLC adopted a flat tax system (a set dollar amount) which is applied on the basis of a combination of litres of product and alcohol content. For instance, the markup

Liquor Barn, owned by Liquor Stores NA, Alberta's largest private liquor retailer.

on a bottle of spirits with between 22% and 60% alcohol content is $13.30 per litre, and is $3.45 per litre on a bottle of wine with alcohol content of 16% or less.61 Private retailers purchase alcohol from the central warehouse at a price that includes the provincial markup and are then able to set their own retail price.

Government Returns from Liquor Sales in Alberta versus Saskatchewan

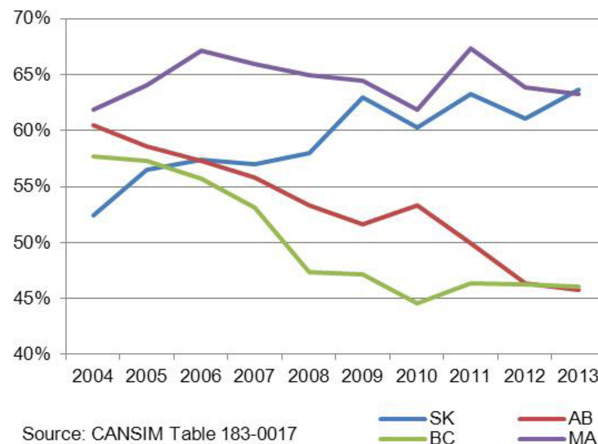
From the citizen perspective, the key question about liquor retail privatization is whether public ownership of the retail assets generates more government revenue than would be the case if the government only acted as the wholesaler. In other words, do the expenses associated with operating retail stores result in larger overall profit. There are, of course, other important considerations. Chiefly, the public health impacts of alcohol consumption. As was discussed in the introduction, years of academic research shows that liquor retailing run strictly for profit by competing private interests tend to contravene the most effective and proven ways in which to limit the social health impacts of alcohol consumption. In a more thorough analysis of the financial implications of liquor retail privatization the associated costs of the resulting impact on public health would be taken into account. The following analysis, however, shows that a straightforward comparison of the ability of public and private retail systems to generate government revenue reveals the superiority of public ownership. The case would only be strengthened by including public health in the analysis.

Return on Investment

Appeals to privatize Saskatchewan's liquor system have in some cases simply pointed to Alberta's larger revenue from liquor sales and its increase over the last two decades. Such arguments are clearly inadequate. Absolute net income figures do not account for the relative size of the provinces nor their liquor retail industries. The return on investment (ROI) measurement used in the previous section is again a preferable measurement of profitability. ROI creates some equivalency among the provinces by measuring net income in relation to total expenses. Similarly, profit margins accounts for Alberta's much larger liquor retail industry by measuring profits in relation to sales revenue.

The ROI is determined by dividing the net income by total expenses (cost of goods sold plus operating expenses). Figure 3 compares the ROI of the liquor operations of Saskatchewan, Alberta, British Columbia, and Manitoba for the past decade. Clearly, the combined wholesale and retail public systems of Saskatchewan and Manitoba have financially performed far superior than Alberta's private retail system and British Columbia's mixed retail system. Saskatchewan's ROI has improved 21% over the decade, from 52% in 2004 to 64% in 2013. Alberta's ROI, on the other hand, has fallen sharply, from 61% in 2004 to 46% in 2013. Essentially, Saskatchewan earns a far better return on the payments it makes to distribute liquor in the province than does Alberta. This is true despite the fact that Alberta and British Columbia are much more densely populated than Saskatchewan or Manitoba, a significant factor in determining the cost of operating a distribution system.[62]

Figure 3. Return on Investment



Looking at just the last five years, if the SLGA had earned the return on investment that Alberta's private system provides the AGLC, Saskatchewan would have forgone more than a quarter of a billion dollars. It must be noted that the poor financial performance of the AGLC is not due to low retail prices. Multiple studies have found that liquor prices in Alberta retail stores are not lower, and are in fact often higher, than those found in Saskatchewan.[63]

This finding may seem counterintuitive. By selling their government-owned stores, Alberta divested itself of the costs associated with operating those stores. If revenues remained the same, the reduction of operating expenses for the AGLC should have boosted their profits. But clearly, all else did not remain the same. There are two key, interrelated changes in the AGLC's finances that followed from privatization: higher wholesale costs and lower markups.

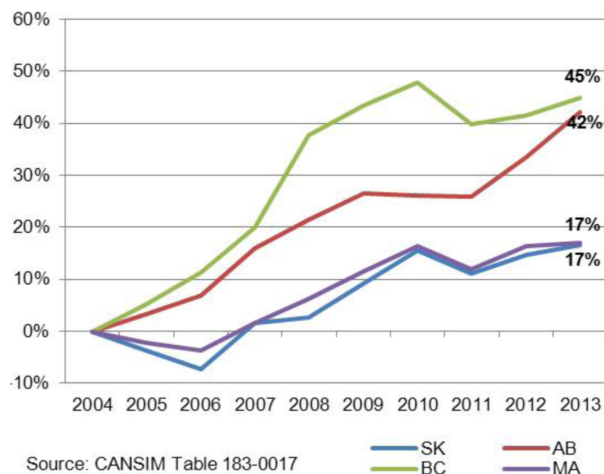
Table 15. Revenue Lost in Saskatchewan with Alberta's ROI, 2009-2013[64]

($2013) (000's)	2009	2010	2011	2012	2013	Total
Saskatchewan's Liquor Profit	$ 211,515	$ 218,570	$ 222,360	$ 222,606	$ 231,310	$ 1,106,361
Saskatchewan's Liquor Profits With Alberta's ROI	$ 173,478	$ 193,245	$ 175,532	$ 168,799	$ 166,115	$ 877,170
Foregone Revenue	$ 38,037	$ 25,325	$ 46,828	$ 53,807	$ 65,195	$ 229,191

Wholesale Costs

As stated earlier, the main cost to a liquor distribution operation is the cost of purchasing liquor from producers and their distributors. The main source of revenue for the public liquor board is from the provincial markups. The graph below shows that the integrated distribution systems of Saskatchewan and Manitoba have had much lower growth in the cost of liquor than the fully-private and mixed retail systems of Alberta and British Colombia. Since 2004, the cost of good sold (COGS) has increased 42% in Alberta and only 17% in Saskatchewan.[65] As the predominant cost faced by liquor distribution operations, the ability to control these costs is paramount to maximizing profitability.

Figure 4. Cumulative Change in COGS



Vertical integration is a common corporate practice because it is a means to control costs and maximize profitability. One reason integration can control wholesale costs is that liquor suppliers need only deal with a single entity in order to sell their product across the entire network. There is no need for the liquor suppliers to intensively sell their products at the retail level, and therefore the marketing and administration costs of the suppliers are minimized, which can result in lower purchasing prices. Under a privatized retail system such as Alberta's, there are hundreds of retailers with which a liquor supplier or agent might have to interact. Not surprisingly then, privatization leading to an increase in wholesale costs was identified as a possibility shortly after privatization was announced.[66] It was not possible, unfortunately, to directly compare examples of liquor supplier quotes for the same products across the provinces, as this information was not forthcoming from either the liquor control boards or liquor suppliers contacted.

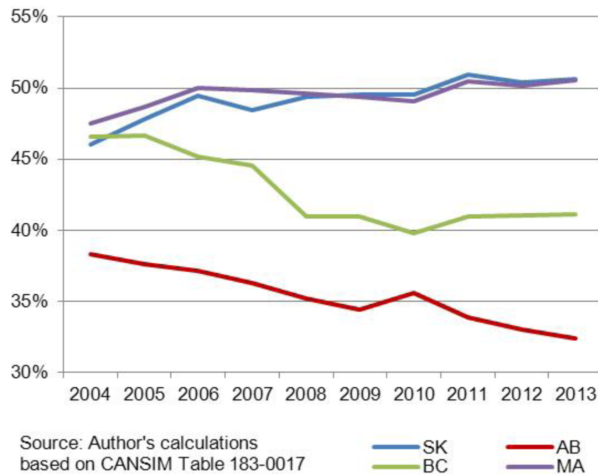
Wholesale costs also increase with the complexity of the retail system. A fractured retail market composed of numerous small, competing stores can also place undue strain on the distribution system. A study on Alberta's distribution system shortly after privatization found that the cost per case delivered rose 72% due to the increased number of smaller shipments.[67] More recently, the AGLC hired a corporate consulting firm to conduct a full analysis of Alberta's warehousing and distribution system after suppliers and retailers reportedly "lost confidence in the current model of liquor distribution in Alberta."[68] The overarching finding of the report was that Alberta's privatized system suffered from the absence of a central actor responsible for the smooth functioning and profitability of the entire system. Instead, the various actors along the supply chain were strictly focused on ensuring their own success in competition with the others and to the detriment of the system as a whole.

Gross Profits

The accelerated growth in the cost of purchasing and distributing wholesale liquor in Alberta is reflected in the province's declining gross profit margins. Gross profit is net income before operating costs, or total revenue minus the costs of goods sold. As seen in the graph below, Saskatchewan and Manitoba have had far higher gross profit margins over the last decade than

Alberta. In 2013, Saskatchewan's gross profit margin was 51%, while Alberta's was just 32%.

Figure 5. Gross Profit Margin



Profit Margins

The result of the public ownership model in Saskatchewan and Manitoba being able to limit the growth of COGS and earn far higher gross profit is that the provinces have higher profit margins even after including the costs of operating the retail stores. In 2013, Saskatchewan and Manitoba both achieved profits margins on their liquor sales of 39%. The same year, British Columbia and Alberta managed only 32% and 31%, respectively.[69]

Table 16. Profit Margins of Liquor Sales in the Western Provinces, 2013

	Profit Margin
Saskatchewan	39%
Manitoba	39%
British Columbia	32%
Alberta	31%

Government Markups

At the same time as the complexity, cost, and strain on Alberta's wholesaling increased, privatization also led to the province reducing its markups. Pre-privatization, the AGLC implemented a percentage-based markup. With the change to a private retail system, the AGLC moved to a flat tax markup with a stipulated dollar fee levied on each unit based on the litre of product and alcohol content. As private retailers took over the retail industry, they argued that the AGLC's markups forced them to increase prices and therefore dampened their profitability. Several months later, in August of 1994 and presumably under pressure from the private retail industry, the government lowered its markups on average nearly 20%. The following year, the government again reduced markups. Markups were raised in 2002, but in absolute terms remain below the initial post-privatization markups.[70] Since the markup is a flat tax, rather than a percentage of landed cost, Alberta's markups have been eroded every year due to inflation. When the provincial government attempted to increase markups in 2009, with the expectation of generating an additional $180 million per year in revenue, it received significant resistance from the retail industry and the government rescinded the increase.[71] Essentially, it has been the province that has absorbed the increased cost of the wholesale operation, instead of passing it onto the private retailers (through higher wholesale prices) or the consumers (through higher retail prices). Saskatchewan's public, integrated system is better able to keep the cost of liquor low while maintaining high provincial markups.

As such, the example of Alberta illustrates the fallacy in pro-privatization arguments that assume liquor mark-ups acceptable in a publicly-run system can remain as high in a private, profit-driven system. Any financial gains Alberta initially accrued from freeing itself of managing the retail stores was quickly evaporated and reversed when the increased complexity and need to appease the new industry meant higher wholesaling costs, reduced mark-ups and lower gross profit margins for the public liquor agency.

Additional Revenue Sources

A full account of the financial impacts of retail liquor privatization must account for two additional sources of public revenue. The SLGA operates 75 retail stores and privatization would mean the assets related to these stores would be sold to private bidders. The sale of these assets would provide a one-time influx of revenue. Privatization would also mean that retailers would pay a share of their profits in provincial income taxes, a stream of income that would be separate from the SLGA's liquor markups.

Asset Sale

In its discussion of privatizing liquor sales in Saskatchewan, the provincial government has alluded to one-time revenue generated by selling off the SLGA's capital assets in the retail sector. For instance, the Premier suggested that the revenue generated by the asset sale could be used "for some important projects or debt retirement."[72] But would the sale of the SLGA's retail assets generate significant enough revenue to actually make a meaningful contribution to such initiatives? And would the government earn a better return on investment with the proceeds from the sale than it would by otherwise retaining ownership of the assets?

Unfortunately, the SLGA does not publish a segmented account of the value of the fixed assets in its liquor operations. Altogether, the SLGA has long-term, tangible assets valued at $106.9 million. As shown in the table below, these include land, buildings, furniture and equipment, gambling machines, and leasehold improvements. From these figures it is possible to estimate the size of the SLGA's liquor retail assets.

Table 17. Fixed Assets of SLGA, 2014[73]

31-Mar-14	Cost (000's)	Accumulated Amortization (000's)	Net Book Value (000's)
Land	$ 4,696	$ –	$ 4,696
Buildings	$ 32,011	$ 21,573	$ 10,438
Furniture and equipment	$ 31,262	$ 18,208	$ 13,054
Leasehold Improvements	$ 11,534	$ 8,364	$ 3,170
Slot Machines	$ 57,118	$ 48,839	$ 8,279
VLT	$ 99,566	$ 32,349	$ 67,217
Breakopen Vending Machines	$ 2,979	$ 2,976	$ 3

The majority of the SLGA's long-term, tangible assets are related to gambling, with $75.5 million worth of slot machines, VLTs, and breakopen vending machines. Therefore, at most, the SLGA has tangible, long-term, liquor-related assets valued at $31.4 million. However, this figure would also include the sizeable assets related to the SLGA's liquor warehouse, which is currently undergoing a multi-million dollar expansion on a new 15 acre parcel of land that the SGLA purchased for $2.43 million.[74] It would also include the value of the SLGA's head office and the furniture and computer equipment inside that would be largely unaffected by the sale of the retail stores. The net value of the SLGA's assets related strictly to its retail stores is therefore likely to be significantly less than $29 million. Considering Saskatchewan's core operational debt is forecasted to be $3.8 billion by the end of the fiscal year, $29 million would pay off less than 1% of the province's debt.[75]

Another way to estimate the revenue the government could receive from selling its liquor stores is to start from asking what the SLGA would be selling. The most valuable assets the SLGA could sell would be its real estate holdings in major cities. Of the SLGA's 75 stores, just 16 are in Regina and Saskatoon, the two major cities which would have by far the most valuable properties. The SLGA has another two stores in Prince Albert, and one in Moose Jaw, both cities with populations over 30,000 where retail

property might have significant value. As seen in the table below, however, of these 19 properties the SLGA only owns 6. The other 13 potentially valuable properties are leased by the SLGA, meaning the SLGA would not be able to sell them. These 13 properties include the majority of the highest earning stores, which likely reflects the desirability, and thus market value, of their locations. Therefore, the extent of the one-time revenue the SLGA could generate from the sale of its retail stores would primarily come from the sale of just six properties.

The five SLGA properties in urban centres that have assessed market values are together valued at less than $5.5 million. Each of the assessments was performed in 2014 except for the Saskatoon store, which had its assessment done in 2011. The South Hill SLGA store in Prince Albert does not have a market assessment available. The SLGA owns the majority of the stores located in the less populated cities and towns not listed, but these are not likely to earn significant revenue from their sale. If the main source of value in the SLGA's sellable liquor retail assets have a market value of less than $5.5 million, it is highly unlikely that the proceeds from selling all the assets would make a significant contribution to the projects mentioned by the Premier. Five and a half million dollars represents less than 0.2% of the province's forecasted core debt at the end of the fiscal year.

As was shown in the previous section, Saskatchewan would forego tens of millions of liquor revenue every year if it had the same ROI of Alberta's privatized liquor system. The small amount of one-time revenue likely generated by the sale of SLGA's retail assets is far less than what would be required to compensate for such annual losses. Moreover, the SLGA's return on investment for their liquor operations was 64% in 2013, as noted above. This is a phenomenal ROI that would be highly unlikely for the government to receive by investing any one-time revenue elsewhere.

Table 18. Profitability of Urban SLGA stores by Ownership Type[76]

	Location	Sales	Net Income	Market Value
LEASED	Quance (Regina)	$ 28,554,564	$ 13,452,975	
	8th St E (Saskatoon)	$ 25,986,710	$ 12,050,900	
	Confederation (Saskatoon)	$ 22,901,704	$ 10,814,949	
	Normanview (Regina)	$ 20,026,207	$ 9,231,651	
	University Heights (Saskatoon)	$ 17,480,044	$ 8,055,367	
	2nd Ave N (Saskatoon)	$ 16,893,205	$ 7,600,441	
	Manitoba (Moose Jaw)	$ 16,636,064	$ 7,658,170	
	Lawson (Saskatoon)	$ 15,824,914	$ 7,088,533	
	Market Mall (Saskatoon)	$ 11,634,270	$ 5,479,474	
	Dewdney (Regina)	$ 11,473,047	$ 5,376,169	
	Broadway (Regina)	$ 9,999,231	$ 4,538,957	
	Broadway (Saskatoon)	$ 6,391,398	$ 2,887,479	
	20th St W (Saskatoon)	$ 2,373,390	$ 863,770	
OWNED	South Albert (Regina)	$ 23,740,836	$ 11,222,312	$ 1,907,500
	South Hill (Prince Albert)	$ 20,591,125	$ 9,960,029	N/A
	North Albert (Regina)	$ 16,316,231	$ 7,537,936	$ 1,029,400
	Idylwyld (Saskatoon)	$ 9,203,213	$ 4,461,566	$ 1,043,400
	9th St E (Prince Albert)	$ 8,743,873	$ 4,209,237	$ 450,000
	Broad St (Regina)	$ 4,290,139	$ 1,703,384	$ 935,100
			Total	$ 5,365,400

Corporate Income Tax

If retail liquor stores in Saskatchewan were privately owned, these businesses would have to pay income taxes on the profits they earned. This would be a stream of revenue that would be in addition to the markup revenue generated by the SLGA acting as a wholesaler, and thus has not been accounted for in the above calculations.

However, it is quite likely that Saskatchewan would receive very little corporate income tax revenue from liquor sales under a privatized system. Corporations in Saskatchewan that earn annual profits of less than half a million dollars essentially pay no income tax. The reason is that Saskatchewan maintains a "small business" corporate tax rate of just 2%.[77] Using the recent financial figures for SLGA retail stores and the 16% discount private retailers would receive, as well as that of Alberta's retail industry, it becomes clear that the stream of corporate income tax from retail liquor sales would be minimal.

How many private retailers are likely to qualify for the small businesses tax rate? In 2014, 21 of the 79 SLGA stores had profits under $500,000.[78] Private retailers, offered a 16% discount from current SLGA retail prices, would have to operate under much tighter margins. Based on the average financial data of all SLGA stores in 2014, and generously assuming private stores are able to cut operating costs in half, a private retailer would require sales of roughly $5 million to exceed the small business cut-off of $500,000 in profits. There is only so much liquor that can be sold in Saskatchewan. In 2014, the 79 SLGA stores sold $447 million worth of alcohol, and less than a third of the stores had sales above $5 million. The vast majority of retailers, located away from urban centres, would be very hard-pressed under a privatized system to achieve sales revenue over $5 million. It is most likely that only a handful of retailers, operating in the major cities, would have to pay the standard corporate tax rate.

The financial statements of private retail chains in Alberta also provide clues to the likely profits of private retailers in Saskatchewan. Liquor Stores N.A. claims to be the largest private liquor retailer in North America. It owns and operates 245 stores, which is more than three times the number of retail stores in Saskatchewan. Roughly three-quarters of their stores are in Alberta, with the rest in British Columbia, Alaska, and Kentucky. In 2013, Liquor Stores N.A. had sales revenue of $661 million from all 245 of its outlets. The company had operating income (pre-tax profits) of $43.2 million, or an average of $176,000 per store.[79] Rocky Mountain Liquor Company is the second largest liquor chain in Alberta. Rocky Mountain had sales revenue in 2013 of $55.9 million across its 46 liquor outlets in the province. The operating income was $2.6 million, or an average of $56,260 per store.[80] The two largest retail chains in Alberta, with economies of scale that would make them the most capable of maximizing the profits of each store, were both unable to come close to averaging profits greater than $500,000 per store. The corporate income tax that Saskatchewan is likely to receive under a private retail system is therefore likely to be relatively negligible.

Conclusion

Saskatchewan's liquor distribution system is a highly profitable enterprise that provides exceptionally high returns for the public. Over the last five fiscal years, the SLGA's net income from its liquor operations has grown 23% and has remitted more than $1 billion to the provincial government over that time. In terms of the financial returns the SLGA receives on its liquor assets, they are exceptional. In the 2014 fiscal year, the SGLA earned a 69% return on its liquor expenses. Not only has the SLGA's ROI increased over the last several fiscal years, it remains several times higher than average returns generated by the U.S. stock market. Moreover, liquor profits have increased over the last several years while the province's rate of alcohol consumption has stagnated. This is a good indicator that the publicly-run distribution system is performing to the criteria citizens should expect: maximizing revenue while minimizing social health impacts. At the same time, liquor prices have closely tracked the rate of inflation.

Regardless, the provincial government appears to be steering the SLGA in a manner aligned with its ideology rather than financial sense. Recent decisions to close publicly-owned retail stores and expand the number of privately-owned retail stores are both financially problematic. The closing of four SLGA stores in rural Saskatchewan will have a negligible impact on the SLGA's revenue but will remove the full services of the SLGA stores and their related economic benefits from four rural communities. Allowing four new liquor stores in Regina and Saskatoon to be privately-owned, instead of by the SLGA, will likely cost the province between $3.5 and $7 million annually.

Similarly, the Premier's proposal to sell-off the SLGA's retail stores to private owners does not make financial sense for the province. In 2013, Saskatchewan's integrated liquor business had a return on investment of 64%, while Alberta's wholesale-only operation had a return on investment of only 46%. If the SLGA earned the same rate as Alberta's liquor system in 2013, it would have foregone $65 million in net income. Even accounting for the one-time revenue generated by the sale of the SLGA's retail assets and the potential corporate income tax paid by private retailers, the province would stand to lose substantial revenue from privatization.

One of the key reasons the public distribution systems of Saskatchewan and Manitoba achieve superior financial results than the privatized retail systems of either Alberta or British Columbia is their success in controlling their predominant business expense: the wholesale cost of liquor. Whereas these costs have risen 42% in Alberta and 45% in British Columbia over the last decade, they have increased just 17% in both Saskatchewan and Manitoba. So while the privatized liquor systems of Alberta and British Columbia have lower operating costs, their rapidly rising wholesale costs mean that their overall profit margins are lower than those of Saskatchewan or Manitoba. In 2013, the profit margins of Saskatchewan and Manitoba's liquor distribution operations were 39%, while British Columbia's was 32% and Alberta's was 31%.

In conclusion, a thorough analysis of the available data reveals no financial reason why Saskatchewan should sell its liquor retail assets. The SLGA currently provides exceptionally high returns to the provincial government while addressing social concerns of alcohol use and avoiding spikes in retail liquor prices. It would most likely earn higher profits by directly owning and operating new liquor stores in urban settings, and it has achieved superior financial results than the privatized systems of Alberta and British Columbia. If the provincial government further privatizes the SLGA, the evidence indicates it will not be to improve the financial performance of the Crown Corporation. The motivation would instead appear to be rooted in ideological concerns.

Recommendations

The following recommendations for the Saskatchewan government come from the above analysis:

1. Maintain public ownership of an integrated wholesale and retail liquor distribution system;
2. Do not license any more private retail stores, and task the SLGA with studying the financial implications of purchasing the four private retail stores already operating in the province;
3. Allow the SLGA to expand its network of retail stores in a way that balances its objectives of fiscal stewardship, customer service, and social responsibility. This will require the Treasury Board to leave the SLGA with the necessary retained earnings to fulfill a long-term capital plan.

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