Alberta

Gaming and Liquor Commission

Liquor Warehousing and Distribution in Alberta – Supply Chain Analysis

FINAL Report

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PRICEWATERHOUSECOOPERS

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1 Executive Summary

Overview

A simple, expedient solution to Alberta's current liquor supply chain challenges does not exist. The alternatives that we analyzed would likely have a negative impact on costs, service levels, product delivery (speed and reliability), and/or product selection.

A number of relatively simple, short-term/interim solutions have been proposed. These include:

- Appointing additional warehousing vendors; and
- Allowing the domestic brewers to distribute the import brands that they represent.

While superficially attractive, it is probable that these interim solutions will fundamentally enhance the positions of certain interests, namely the supplier / agent community, to the potential disadvantage of retailers and consumers. As well, attempting to establish a new service delivery model at this time increases the risk of not being able to meet the 2007 peak.

The Alberta liquor industry supply model is predicated on balancing the interests of all stakeholders. Altering that balance will need careful consideration.

Recognizing the needs, priorities and balance above, we have worked with the AGLC to develop a proposed multi-track approach, which is geared to:

1. Ensuring that stability and predictability are returned to the supply chain in the near term (the next one to two years) working within the existing delivery model. Mandatory supply chain planning and forecasting, under the direction of the AGLC, would be required;
2. Evaluating the costs, benefits, risks and policy implications of different supply chain models; and
3. Identifying the best long-term alternative, based on balancing AGLC's needs and priorities, and help AGLC to develop a transition strategy to move from the current model to the future model.

Background

Until recently, the privatized model for liquor distribution in Alberta has worked reasonably well.

- Consumers have seen an almost 300% increase in the number of products they can choose from; they can now purchase liquor from over 1,100 retailers in communities throughout Alberta; liquor retail prices have remained relatively stable.
- Retailers have had reliable, predictable delivery of liquor throughout the province at a standardized cost.
- Agents have been able to introduce new products to the market with a minimum amount of "red-tape".
- The Government of Alberta has met its policy objectives as established at the time of privatization.

Current Situation

Alberta's provincial alcoholic beverage operating environment has undergone significant change since the introduction of private sector control of the delivery mechanism in 1993.

- Consumers expect the increased availability and selection of products.
- The number of retailers and licensees has increased significantly; larger retailers and retail chains have become more established.
- More recently, some larger retailers have started to use their buying power to negotiate volume discounts with suppliers through the existing LTO (Limited Time Offer) process.
- The complexity of warehousing and distribution has increased significantly with the number of products that must be brought in, unloaded, stocked, picked, packed and shipped.
- The charges per case to stock, pick and ship fast moving, high volume products is identical to the charges for slow moving products in spite of the potentially huge disparity in work effort involved. This has created the situation where high-volume products are effectively "cross-subsidizing" a growing number of slow moving products.
- The willingness of the existing warehouser to make anything but tactical investments is hampered by the fact that they have not operated with a long term contract with the AGLC. Connect Logistics Services (CLS) has operated with several inefficient "satellite" warehouses and retailers have been permitted "storage facilities".
- The lack of a formalized planning and forecasting process involving all stakeholders (suppliers, agents, freight forwarders, warehouser and retailers) greatly reduces the ability to predict potential bottlenecks in the supply chain. Ultimately, the warehouser is forced to make prioritization decisions (due to finite capacity) that may be inconsistent with the desires of either the suppliers or retailers.
- The available capacity in the existing warehouse at key moments during peak seasons has been exceeded given that the flow is not managed against a formalized plan.
- No incentives or disincentives exist for good / poor performance or cooperation to ensure efficiency by suppliers, agents or the warehouser. The implications of this are that poor performance by one stakeholder in the supply chain can cause significant pain at other points in the supply chain.
- The "hands-off" approach taken by the AGLC in establishing formal performance measures and monitoring performance against these indicators has resulted in tactical decisions to issues as they arise instead of proactively planning and recognizing problems before they occur.

In preparation for 2007, CLS is making significant investments to enhance current capabilities. These include:

- A new Warehouse Management System (WMS);
- Dividing slow moving items into their own specialized warehouse (mixing centre) with consolidation at St. Albert. St. Albert will then be primarily used as a distribution centre rather than a mixed storage and distribution facility (all of this enabled by the new WMS);
- Improved racking layouts and automation at St. Albert commensurate with St. Albert's revised role as primarily a distribution centre; and

- Further development of the labour plans to ensure staff retention and availability including preparing for the importation of labour from outside Canada. It should be noted that staff training lead times mean that there are delays of up to 3 months between an employee starting and being fully productive.

However, CLS has made limited or no quantitative analysis to date of the actual impacts these investments will have in terms of improved efficiency and capacity. Indeed the working details such as the timing of flows (with consequent impact on order to delivery lead times) between St. Albert and the "mixing centre" are being designed while this report is being prepared. In addition the proposed moves will need to be phased as the new mixing facility is brought on line, the WMS implemented, and existing facilities rationalized. This work will likely continue until the fall of 2007.

The Challenge

- Suppliers, agents and retailers have expressed that they have lost confidence in the current model of liquor distribution in Alberta.
- The concept of "open, free market" as defined by the suppliers/agents and some large retailers is incongruent with "fair and level playing field" as originally defined by the Alberta model and understood by most retailers.
- No one is "managing" the flow of goods in the supply chain.
- Industry stakeholders are looking for the problem to be fixed yet they cannot agree on the best alternative for solving the problem. Not surprisingly the solutions proposed reflect their commercial interests and do not point out the implications for the other players in the chain or on consumers.
- Any solution implemented in the short-term can only be a stop-gap solution.

Conclusions

- The existing system makes it difficult to define who is responsible for service failures. During the review, each segment of the industry sought to "point fingers" at the others without recognizing the limitations each player was working under.
- The existing system does not require the players in the supply chain to cooperate in any meaningful sense.
- Based on observation and the qualitative information supplied, it is unlikely that the current warehouse operation is sustainable without a significant increase in capacity or the better use of the existing capacity.
- Processes and systems to support sensible business planning and execution are inadequate.
- The allocation/communication/agreement of industry roles, responsibilities and accountabilities to make the system run smoothly is inadequate; and
- The lack of a performance management framework creates little or no incentive for CLS to be responsive to changing business requirements.

Recommendations

The recommendations made are based on the assumption that fundamental market shifts have occurred that require the development of new liquor distribution model for the Province of Alberta. This new industry model will require clear allocation of roles, responsibilities and accountabilities of key industry players throughout the supply chain.

These recommendations are tiered into short, medium and long term actions.

Short Term

Short term is defined as beginning March 2007 with the initial analysis completed by the end of May 2007, implementation and monitoring through the balance of 2007; to be repeated in 2008.

- The AGLC must take a more active role in managing elements of the industry – particularly in the supply chain – to ensure that service levels and stakeholder confidence are returned to the industry.
- Retain CLS as the sole warehouser / distributor for the distribution of liquor in the province of Alberta at this time, but with a more rigorous contractual regime. Do not make short term changes such as changing the beer distribution arrangements or introducing new warehousing vendors. Such changes are likely high risk as they will add complexity and set precedents in advance of the development of a longer term strategy.
- Formalize the "service provider" relationship by defining, negotiating and signing a contract with CLS to provide services that includes conditions if performance is / is not met.
- Establish and implement formal performance measures against which CLS performance will be monitored; indicators need to include:
  - On-time delivery;
  - Accuracy of shipment; and
  - Customer service.
- Work with CLS to develop a new, expanded, rate structure to better reflect the relative costs of ordering, handling and storing fast moving items as compared to slow moving items. Implement this new rate structure in the summer of 2007 so that it is aligned with the move to the "mixing centre".
- Require all upstream and downstream stakeholders to provide volume and timing forecasts for 2007 (and 2008) to CLS so that proper forward planning can be performed. Ensure that the plan is quantified and tested.
- Establish "rules of engagement" for the suppliers/agents and retailers based on the forecasts used for planning 2007 and subsequently 2008. These rules will be used to regulate product flows and responsibilities and will include consequences if rules are broken.
- Retain the services of a qualified supply chain specialist to support the AGLC including reviewing the plans and monitoring implementation/operation on, at minimum, a monthly basis.

- In the event that supply and/or demand spikes unreasonably at some point, the AGLC would reserve the short term right to impose limits on supply or ordering during certain periods.
- Short list options for refining the LTO system; for example, remove anomalies such as small retailers being forced to wait until their order day before they can order LTOs. Changes such as this will be complex at a detailed level and will require careful consultation with all the parties involved. This project should be completed, however, by June 2007.
- Subject to any legal considerations, give notice to CLS that, as a consequence of the changes described above, the existing “appointment” arrangement will revert to a more typical “services contract” arrangement with an expected term to coincide with a transition period following the possible re-tendering of the contract in approximately two years from now. The duration of the transition period would likely be determined during the development of the RFP documents in late 2008.

Medium term

Medium term is defined as beginning in March 2007 with the analysis and policy options ready for discussion/decision by August 2007. Target Implementation beginning in 2008 or 2009 depending on the final policy decisions.

Develop an operational and financial business case that considers four options for the physical network:

1. Recreate an environment where the supply network is sized to be larger than the expected peak volume for a number of years to come (essentially the situation at privatization). This option will be capital intensive and likely wasteful as it will involve the building or leasing of facilities which will be underutilized other than at exceptional activity peaks. As consumption grows this solution will at some point again run out of capacity provoking another “crisis”. Another version of this strategy has warehouses (and warehousers) being added. This approach will also add to the work of the AGLC, especially in its capacity as “first receiver”. Maintaining a uniform service for all products and a uniform price structure for all retailers will increasingly not be feasible as more and more locations are added decreasing the efficiency of the system. The likely result is that Agents/Suppliers will seek to favour a limited range of retailers and “neglect” the rest.
2. Act more proactively as the regulator either directly, through a third party or through the warehouse operator and dictate the priorities at peak times to the suppliers and retailers based on projections that the suppliers and retailers would be required to provide for planning purposes. In principle this goes against the “free market” principles that Alberta has espoused since privatization. It requires the AGLC to “re-engage” as a regulator (at least in the last resort) of operations as well as its ongoing fiscal and social responsibility role.

   As structured today the AGLC does not have the skills or the resources to undertake this role other than in what would likely be an arbitrary fashion. The current privatization model is structured to offer a “level playing field” to all retailers which in turn has meant an operating construct that does not allow a “free” market for services such as warehousing to develop (as it would have been complex to achieve while ensuring level pricing and delivery to all retailers and would have required, for example, a detailed regulated wholesale pricing regime). In this situation, the AGLC is now faced with either maintaining the current principles, which would in turn mean the AGLC returning to a more interventionist role in "managing" the operations of the service providers similar to a utility model, or of changing the privatization model with the core options being described below.

3. Adjust the principles of privatization to enable the suppliers to take control openly of the supply chain and to manage it. This option is one that is rarely seen in the consumer goods market. The state of Iowa evaluated this model for liquor distribution a number of years ago and concluded that it was not in the best interest of the state (see section 4.3). However, it is still an option that needs to be carefully considered.
4. Adjust the principles of privatization to enable the retailers to take control of the supply chain and manage it. This model is the one which has evolved as the most common model for consumer goods globally, particularly in the last 30 to 40 years. The retailers are closest to the consumer. Adoption of this model would however require care to ensure that the interests of all groups are considered.

Selecting amongst these choices will be difficult. Each one will have significant consequences for all the parties involved. The decision making process for this long-term strategic direction will require significantly more in-depth analysis. The review would consider the financial, operating and consumer implications of the options and would lead to recommendations on which approach should be adopted and what operating principles / policies would be needed. In making this review the following key priorities would be followed:

- Compliance with Federal requirements;
- Maintaining social responsibility;
- Ensuring a diversity of products;
- Ensuring service and price competitiveness to all Albertans;
- Supporting employment and enterprise in the retail sector; and
- Securing the revenue flow to the Province of Alberta.

Long term (2009 onwards)

Based on the results of the in-depth review, issue an RFP for one or more warehousers to deliver warehousing and distribution services for a defined contract term (for example, 5 years). The transition to any new vendor, or to the terms of any new agreement, would take place over a time period to be defined during the RFP process. The time required for transition would in part depend on whether there would be a requirement that any successful bidder(s) continue to operate from St. Albert or if they would be free to create a new network (or use parts of the existing system). Analysis of this question should form a part of the business case analysis described above.

2 Introduction

The receipt of liquor product from suppliers and agents, and the distribution of liquor product to licensees from the Connect Logistics Services (CLS) warehouse in St. Albert have encountered a number of significant supply chain issues over the last year. These supply chain factors have caused issues for suppliers, agents, and liquor licensees, and attracted licensee and media attention.

PricewaterhouseCoopers LLP (PwC) has been contracted by the AGLC to conduct a review of the liquor warehousing and distribution supply chain in Alberta, with a view to proposing resolutions to the supply chain issues facing the provision of spirits, wine, coolers and imported beer in Alberta.

The scope of this review specifically excluded "finding fault" related to the events of the past year. Rather, its purpose was to bring an independent perspective to the process as the AGLC and its stakeholders look ahead to the future.

This document is divided up into the following sections.

- **Section 3** – provides an overview of the basic elements of Supply Chain Management (SCM).
- **Section 4** – describes the approach that was used to complete this review and includes summary information about the data gathering phase.
- **Section 5** – describes some "best practices" that one would expect to see in highly efficient supply chain operations and provides a review of two other liquor distribution jurisdictions.
- **Section 6** – provides a summary of the feedback from the stakeholders. It also includes PwC comments on this feedback.
- **Section 7** – summarizes the conclusions that PwC has drawn from analyzing the feedback based on our industry expertise and knowledge of best practices.
- **Section 8** – describes the alternatives that AGLC has for going forward.
- **Section 9** – outlines our recommendations for going forward.
- **Appendix A** – provides a list of respondents.
- **Appendix B** – is a copy of the AGLC *Liquor Supply Chain Discussion Paper*.

3 Overview of Supply Chain Management

This section provides an overview of Supply Chain Management (SCM) so as to ensure that the findings and recommendations are provided within the context of an overall SCM Framework.

In its simplest form, a **Supply Chain** refers to the distribution channel of a product, from its sourcing, to its delivery to the end consumer (see Figure 1).

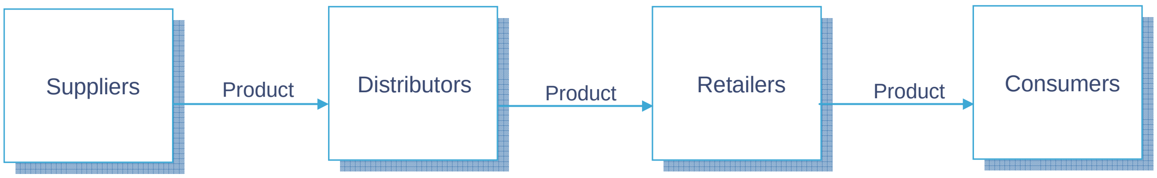


Figure 1 – Supply Chain

Supply chain management (SCM) involves the coordination and integration of product flow, information flow and finance flow both within and among companies (see Figure 2).

- The product flow – includes the movement of goods from a supplier to a customer
- The information flow – involves communicating information about the product as it passes through the supply chain (e.g., purchase orders, shipping notices, delivery status).
- The finance flow – includes payment schedules, and consignment and title ownership arrangements.

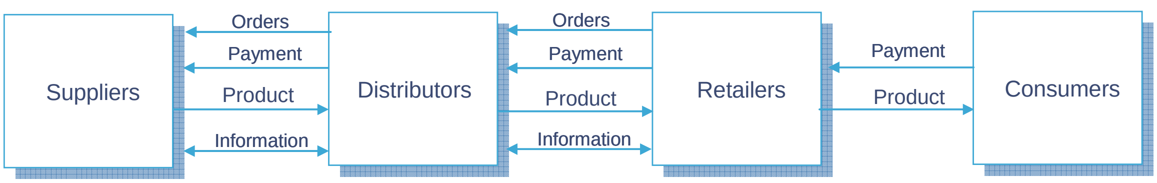


Figure 2 – Supply Chain Flows

The primary objective of supply chain management is to have the right products, in the right quantities (at the right place) at the right time at an acceptable cost. Key questions that need to be answered with this in mind are:

- **Right products** – how many different products should be carried? Should different sizes of the same product be carried?
- **Right quantities** – how much of a particular product needs to be ordered? Are there minimum order quantities (either from the supplier or from retailers)?
- **Right time** – how fast does the product need to be delivered? How reliable is the delivery? How accurate is the delivery?
- **Acceptable cost** – what are the costs of carrying inventory? How much will it cost to get a certain number of products within a certain timeframe? What is the change in cost if a different quantity is ordered? If a different product is ordered? If a different delivery time is required?

These questions suggest that there are a number of areas of focus (or performance dimensions) that must be considered within the supply chain (see Figure 3).

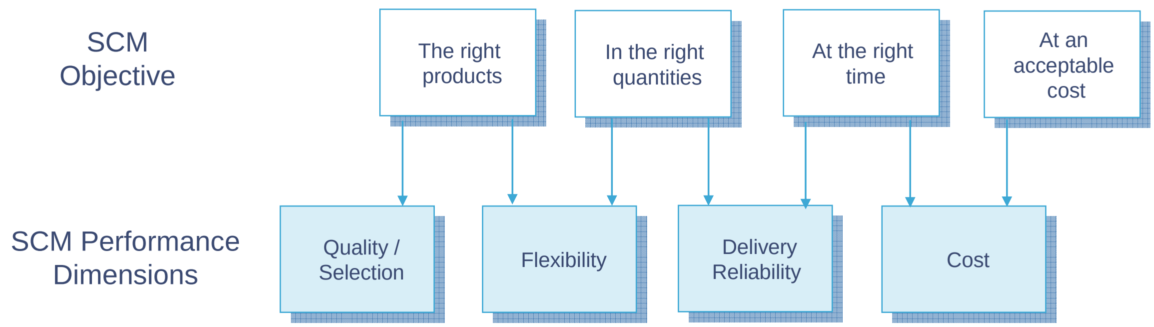


Figure 3 – Supply Chain Management Performance Dimensions

The challenge with these performance dimensions is that excellence on some dimensions may conflict with excellence on others. In such cases, firms must make trade-offs emphasizing some dimensions at the expense of others (see illustration in Figure 4 below). Supply chain managers must understand which performance dimensions are most valued by their targeted customers, and act accordingly. For example, Firm 1 places its priority on fast, reliable delivery for a limited number of products (and places little value on being able to order in different quantities). Firm 2, for the same cost, prefers to offer a wide selection of products in a wide variety of sizes and quantities, and is prepared to wait for delivery. This concept is particularly important to understand when we look at the liquor distribution supply chain in Alberta.

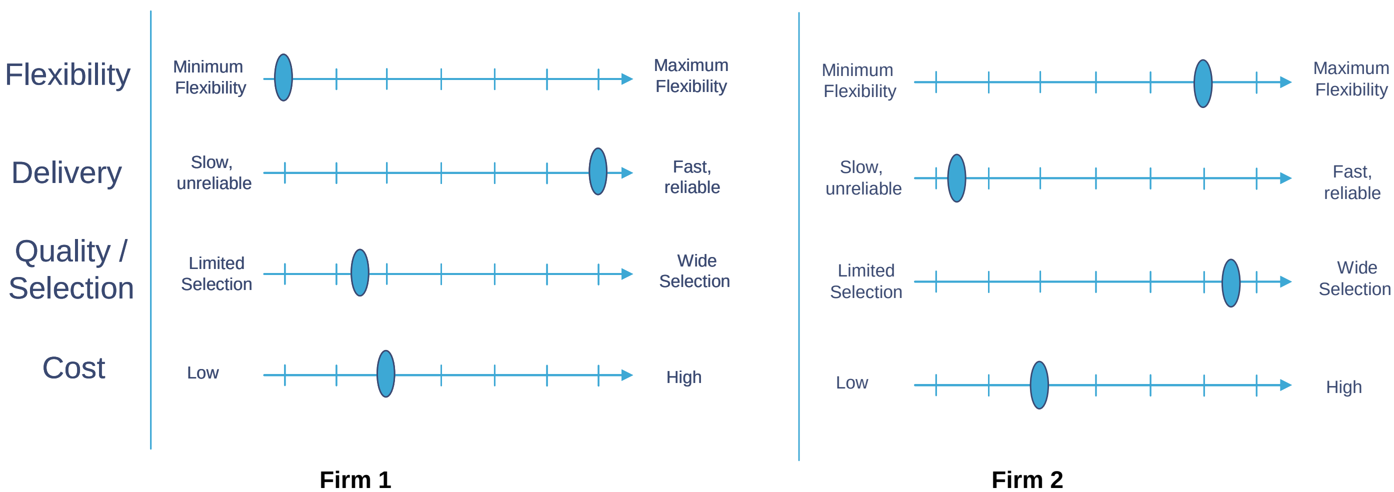


Figure 4 – Trade-offs in Supply Chain Management

4 Approach

This section describes the approach we used to complete the work. The approach consisted of four key steps:

1. **Data Gathering** – This step involved the meetings with the key stakeholder groups and the consolidation of the written responses from licensees, associations, agents, suppliers, freight forwarders and Connect Logistics Services.
2. **Research -** This step involved a review of supply chain best practices and a review of liquor distribution in other jurisdictions. This material is included in Section 5.
3. **Analysis** – this step involved analyzing all the material collected in the context of the Alberta's liquor distribution supply chain. Findings and Conclusions are summarized in Sections 6 and 7 respectively.
4. **Reporting** – this step involved identifying alternatives for moving forward and making recommendations based on existing realities. Alternatives and Recommendations are summarized in Sections 8 and 9 respectively.

4.1 Stakeholder Meetings

Meetings with the following stakeholder groups were conducted on the following dates:

• Alberta Liquor Store Association (ALSA)	January 9, 2007
• Alberta Liquor Industry Roundtable (ALIRT)	January 9, 2007
• Alberta Hotel and Lodging Association (AHLA)	January 10, 2007
• Spirits Canada	January 10, 2007
• Connect Logistics Services (CLS)	January 11, 2007
• J. F. Hillebrand	January 11, 2007
• ContainerWorld	January 15, 2007
• Canadian Council of Grocery Distributors (CCGD)	January 16, 2007
• Beverage Alcohol Importers Council of Alberta (BAICA)	January 16, 2007
• Alberta Restaurant and Foodservices Association (ARFA)	January 18, 2007
• Canada's National Brewers	January 18, 2007
• Canadian Restaurant and Foodservices Association (CRFA)	January 19, 2007

4.2 Consolidation of Written Responses

Written responses (some general comments, some direct responses to the questions in the Discussion Paper) were received from over 50 agents/suppliers, licensees, and associations. The list of respondents is included in Appendix A. A breakdown of responses is shown in the following graph.

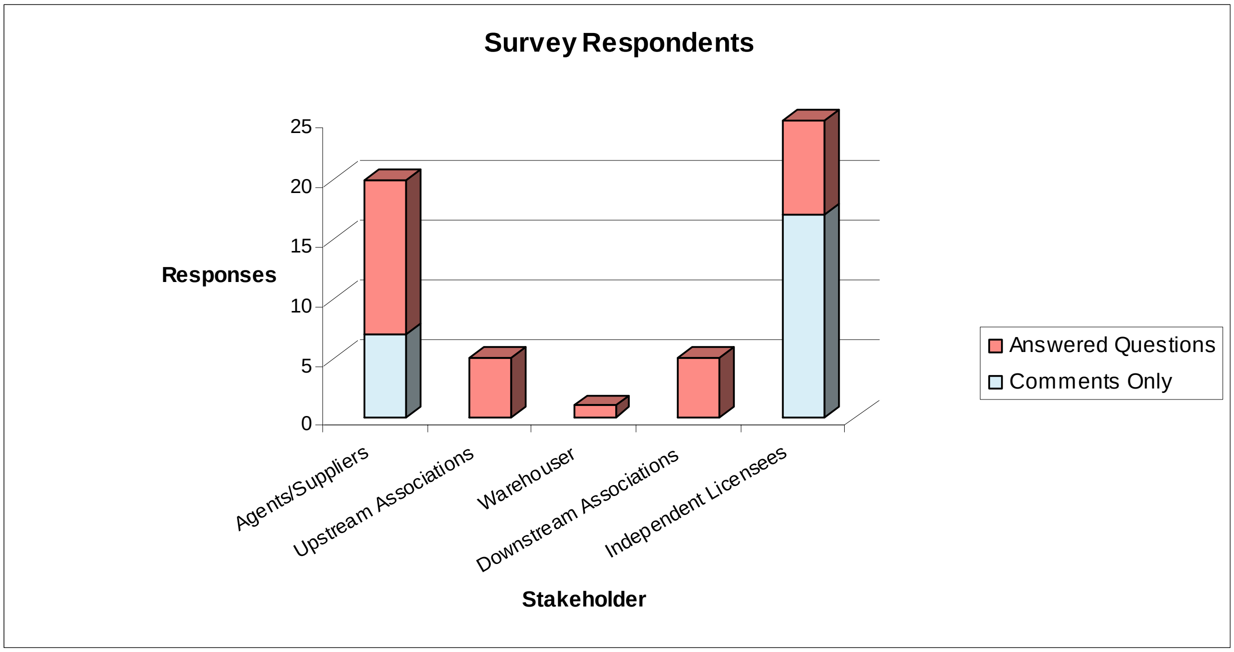


Figure 5 – Survey Respondents

A detailed breakdown of responses by question is provided in Section 6.

5 Research

5.1 Best Practices

A best practice is a technique or methodology that, through experience and research, has proven to reliably lead to a desired result. Within the context of supply chain management, best practices mean understanding one's operations and costs thoroughly, getting the best return on investment, satisfying customers and understanding that the job is never done (as one must constantly adapt to changing market conditions).

A number of best practices apply to many warehouses and distribution centers. They include the following:

1. **Collaborate with external supply-chain partners.** Companies must communicate and collaborate with all supply-chain partners in order to know the location and movement of product at points throughout the chain
2. **Use advanced shipping notification (ASN).** With ASN, suppliers notify receivers in advance, letting them know they are shipping a specific purchase order, and giving an expected arrival time. Knowing what is coming into the warehouse enables managers to preplan receiving for the day. With a limited number of dock doors, inbound receipts need to be scheduled. A central point of communication is critical for this to work.
3. **Measure the right things.** Many companies have no idea whether they're executing against plan. Was product shipped / received on time? Did the supplier produce the promised amount of product? Some of the metrics that are often used in measuring the effectiveness of the supply chain are: forecast accuracy, variance to the baseline forecast (in other words, how it was adjusted to meet reality), actual demand versus budget, adherence to the demand plan and adherence to operational and logistics plans.
4. **Integrate supply- and demand-planning tools.** By synchronizing supply and demand, companies can access data from various parts of the supply chain helping it to better plan.
5. **Implement a vendor compliance program.** A vendor compliance program involves integrating operations at the distribution centre with the suppliers. This may include specific labeling requirements, and standard case quantities for each individual item. Done properly, suppliers help the distribution centre achieve maximum throughput and maximum efficiency, in a minimum amount of time by ensuring that the arriving product is configured for easy handling within the facility. A key responsibility in this is to look at what percentage of the vendor's purchase orders comply with requirements, and where they're complying.
6. **Use system-directed replenishment.** If the inbound product isn't put into a pick location immediately, using system-directed replenishment is a best practice. System-directed replenishment is based on real-time information that looks at the pick slot's stocking condition and the quantities that will be picked in the next wave, putting you one step ahead of the order picker. Information systems should drive replenishment so the location is never out of stock when pickers are picking.
7. **Consider dynamic slotting.** Slotting a stock keeping unit (SKU) in the optimum location requires ongoing analysis. As items move through the maturity cycle, their

velocity changes. Other items are seasonal in nature; slow-sellers may become fast sellers during peak months of the year. One option is to have system-generated exception reports to make ongoing slotting changes.

8. **Implement an ongoing cycle count program.** A good, ongoing cycle count program enables you to eliminate taking a physical inventory count. While many firms do cycle counting, they have not yet eliminated the physical inventory. Doing so cuts time and costs substantially.
9. **Use best practices in measurement.** Be careful how you develop metrics and measure performance. Take an order picking accuracy example: Your selectors pick 100 cases, and in one order, pick two cases of Product A instead of two cases of Product B. Some customers may identify that as two errors, and say you've shipped two of the wrong item, achieving 98-percent accuracy. However, it could also be four errors, or 96-percent accuracy, as you've over-shipped two of Product A, and under-shipped two of Product B. This, in effect, creates four errors for the customer. Use this "gross error method" to calculate accuracy most effectively.
10. **Continually evaluate requirements.** Customer requirements keep changing and accelerating. That means you need to be looking at your customers' requirements every few months to see how they are changing.

5.2 Review of Other Jurisdictions

The analysis step in this review included an assessment of what is done in other jurisdictions both within and outside of Canada. Most applicable were:

- The Iowa Alcoholic Beverage Division (ABD);
- The Government of Ontario *Beverage Alcohol System Review* (BASR)

The Iowa Alcoholic Beverage Division was reviewed for a number of reasons:

1. Of all the jurisdictions in North America, it is virtually identical to the current Alberta model.
2. The ABD conducted a study in August 2002 to respond to questions regarding the financial and regulatory effects of the state being involved in the business of wholesaling liquor. The results of the study provide insights that may be of value to the AGLC as it looks ahead to possible solutions to its supply chain issues.

The Government of Ontario BASR review was reviewed because:

1. It compared and contrasted the pros and cons of different liquor distribution models of jurisdictions both within North America and internationally.
2. It showed how different supply chain models can be used to maximize key performance measures (in this case, revenue to the province) depending upon the trade-offs one is prepared to make (in this case, limiting the number of retail outlets within the province).

5.2.1 The Iowa Alcoholic Beverage Division (ABD)

The primary question addressed in the August 2002 study centered on the state’s continued involvement in the liquor wholesaling business and whether “Iowa would be better off financially to “sell off” the liquor business and turn the system over to privately-owned liquor wholesalers.”

The study proved the following:

- Iowa makes a net profit of over $39 million annually from wholesale liquor operations. By being directly involved in liquor wholesaling, Iowa keeps the profit that would otherwise go to private sector wholesalers.
- By law, the ABD treats all retailers equally in regards to product pricing, regardless of quantity purchased. This “level playing field” practice has enabled over 200 smaller independent retailers to successfully compete with over 200 chain operations in Iowa. This is particularly important to retailers / consumers located in smaller cities and in rural areas.
- There would not be “price competition” but rather “brand competition” under a private wholesale system. The ABD projects that 2-3 wholesalers would initially take over the wholesaling function and the field would eventually be whittled to two wholesalers (The State of California has two major wholesalers serving a population of 35 million.)

  The projected wholesalers, who already serve as supplier brokers in Iowa, have business and financial ties with major liquor suppliers. Liquor suppliers do not offer their product lines to multiple wholesalers within a state unless forced to do so by law; the preferred method by suppliers is to franchise with one wholesaler to carry the supplier’s entire product portfolio. Consequently, Iowa retailers will not be able to “shop” different wholesalers for the best price on any particular product. Retailers will be forced to purchase a particular brand from a particular wholesaler. In effect, Iowa would be trading a “public” monopoly for a “private” monopoly.

Iowa, through the operations of the Alcoholic Beverages Division, has created an efficient wholesaling system that maximizes revenue for state and local government programs and substance abuse treatment efforts, minimizes the cost of industry regulation and creates a level competitive playing field for Iowa retailers.

Privatization of Iowa’s liquor wholesale system would either result in the loss of millions of dollars annually or would result in significantly higher liquor prices to the Iowa consumer.

A copy of the complete study is available at http://www.iowaabd.com/doc/warehouse_study.pdf

5.2.2 The Government of Ontario *Beverage Alcohol System Review* (BASR)

The Ontario government established the Beverage Alcohol System Review Panel in early 2005 to determine if the beverage alcohol system was generating the maximum benefits for the people of Ontario.

The Panel concluded that if the beverage alcohol system is to generate significant additional returns for the people of Ontario, it will be necessary to make the system much more open and competitive while continuing to ensure the socially responsible sale of alcohol.

The Panel studied other jurisdictions and found that a variety of regulatory strategies can ensure social responsibility in the sale of beverage alcohol. It is not necessary for government to own and operate wholesale and retail facilities to do this. The research indicates that active enforcement and retail prices are the most effective means for controlling access to alcohol.

The fundamental conclusion was that to create an open and competitive system, maximize government revenue and protect social responsibility and other public interests, the government withdraw from retail and wholesale operations and implement a licensing system for the retailing and wholesaling of beverage alcohol in Ontario.

On the retail side, licences to retail the full range of beverage alcohol products for a fixed term would be auctioned individually to the highest bidders. Each package up for auction would also include the business assets of an LCBO store. Stores could be moved within geographic zones. A beverage alcohol outlet could be located within an existing retail establishment (such as a grocery store), provided that the existing premises and the beverage alcohol outlet met licensing requirements recommended in the report.

On the wholesale side, up to 10 licences to wholesale the full product range province-wide for a fixed term could be auctioned. The LCBO's warehouses would be included in the auction.

The government would collect the auction proceeds in instalments over the term of the licence. At the end of the term, licence-holders would be required to re-bid in a new auction. In this way government - and taxpayers - would receive additional value regularly and permanently.

To protect social responsibility, the new beverage alcohol system would:

- maintain approximately the present total number of retail outlets province-wide and limit the number of outlets in geographic zones;
- set strict site requirements for beverage alcohol retail outlets, and regulate their opening hours, to ensure that alcohol is not treated as an ordinary consumer product;
- continue to enforce a minimum-price policy for beverage alcohol products;
- establish a comprehensive regulatory regime that would:
    - ensure that all beverage alcohol in Ontario is monitored by the government, from importing or manufacturing through wholesale, distribution and retail sale and service on licensed premises;
    - set clear operating rules for the wholesale and retail licence-holders and for all licensed establishments, with progressive sanctions for non-compliance;
    - require sales staff of the licensed retailers to participate in ongoing social responsibility education and awareness programs and to complete approved testing on responsible sales practices;
    - increase funding for inspections, enforcement and adjudication to ensure timely imposition of sanctions.

To implement the transformed system, the government would collect its charges on beverage alcohol when the products enter the wholesale channel. And the existing players - BRI and wineries with retail stores located off the winery site - would be offered opportunities to make a smooth transition to the new environment.

Under this strategy, the government would retain the equivalent of all the revenue it currently obtains from the system and, after a transition period, would reap $200 million or more annually from the auction process.

Moreover, an open, market-driven system would put the focus on the consumer. It would deliver more convenience, broader selection and competitive prices. New wholesale and retail channels would give small producers and makers of niche products greater access to the marketplace - boosting economic growth.

A complete copy of this report is available at:
http://www.fin.gov.on.ca/english/consultations/basr/report.html

After receiving the report, Government of Ontario Finance Minister Greg Sorbara indicated that he would rule out a major recommendation by the panel to sell the Liquor Control Board of Ontario (LCBO) stating that "…the public interest of Ontarians is best served by the continued public ownership of the LCBO."

5.2.3 Lessons Learned

Both of these examples demonstrate the need for making trade-offs in determining the "optimal" liquor distribution model for a particular jurisdiction. These trade-offs are at both an operational level and philosophical (policy) level.

In Iowa, the priority was on maximizing revenue for state and local government (by retaining control over liquor wholesaling), minimizing the cost of industry regulation and creating a level competitive playing field for Iowa retailers. The study confirmed that other distribution models would not meet these priorities.

In Ontario, the priority was again on maximizing benefits (i.e., revenue) to the province. However, the recommended approach for achieving this was quite different than the Iowa model. In this example, the Review Panel recommended that the government withdraw from retail and wholesale operations and implement a licensing system for the retailing and wholesaling of beverage alcohol in Ontario. By limiting the number of wholesalers and retailers, and requiring an "auctioning" process to acquire a license, the province could increase its revenues, while purporting to deliver more convenience, broader selection and competitive prices. This change did not happen, so the opportunity to see if the desired results materialized did not occur.

6 Findings

This section provides a summary of the comments received from the stakeholder input received in January and individual responses from suppliers / agents and licensees. The questions used in the discussion paper (see Appendix B) have been repeated starting in Section 5.4 to ensure consistency in the results. PwC comments are provided at the beginning of each section to provide context for the comments that follow.

6.1 Alberta's Liquor Supply Chain

The supply chain shown in Figure 1 shows the flow of product from suppliers to distributors to retailers to consumers. Alberta's Liquor Supply Chain has added complexity (especially from an information flow perspective) given that agents and freight forwarders play a significant role in the upstream portion of the supply chain. An agent may represent multiple suppliers; a supplier may use multiple agents; an agent may use one or more freight forwarder; suppliers may ship directly to the warehouse.

Combine this with the reality that the distributor (Connect Logistics) must provide a consistent level of service for all products, from all suppliers to all retailers (and that they have no control over how many products are brought into Alberta), and the challenges increase even more.

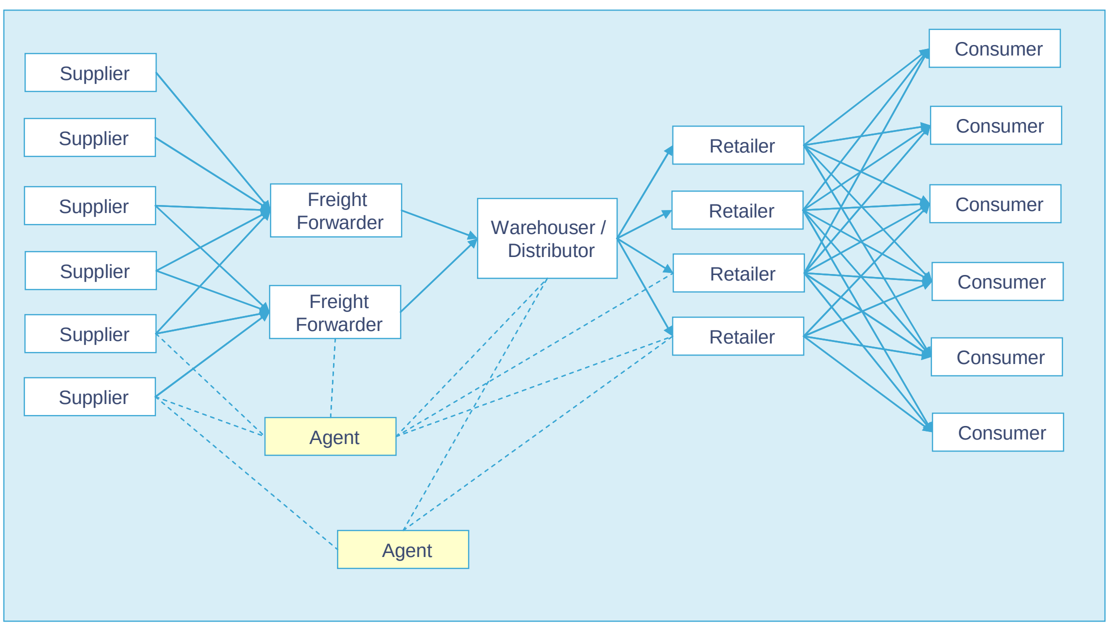


Figure 6 – Alberta's Liquor Supply Chain

In spite of these challenges, the supply chain has worked well since privatization as evidenced by some of the comments received from different stakeholders.

> *"Alberta's supply chain is likely the most innovative in North America."*
> *"For the past thirteen years this model has worked well."*
> **Alberta Liquor Store Association**
>
> *"From 1993 until early 2006 {we} received "Cadillac Service" from CLS.*
> **Independent Licensee**

The trade-offs made within the liquor supply chain in Alberta would be similar to those shown in Figure 7. This diagram shows that since privatization, the emphasis has been placed on finding the balance between the four performance dimensions. Until recently, the balance was reasonably well maintained with an emphasis on product selection (as noted by the 300% growth in SKUs). This was balanced with a reasonable (but achievable) delivery schedule (24-48 hours) and a reasonable order quantity (25 case minimum). The challenge is that different stakeholder groups want different priorities. The impact on the costs will be dependent on what decisions are made in the other three areas.

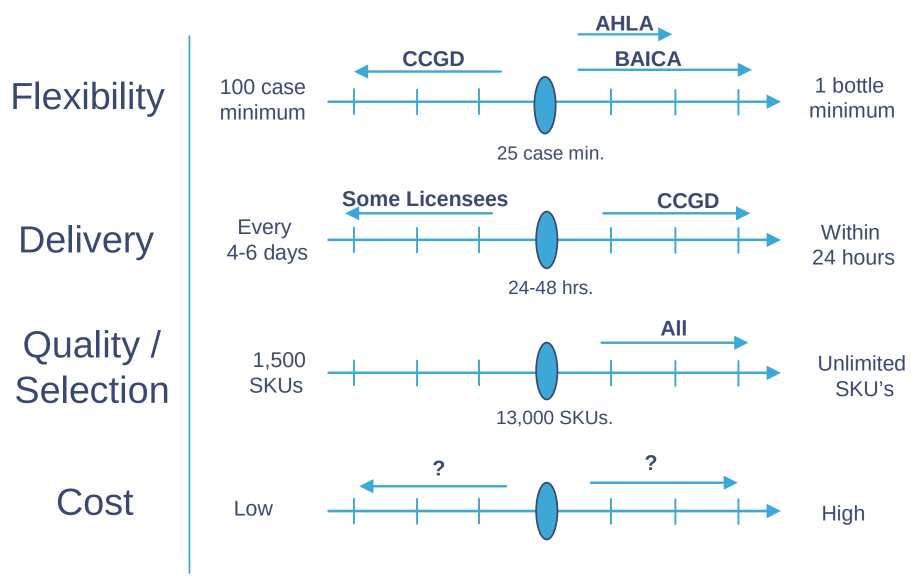


Figure 7 – Trade-offs in Alberta's Liquor Supply Chain

6.2 *Upstream Association Responses*

This section provides a summary of the responses received from the three upstream associations. The comments included for each stakeholder are taken directly from written submissions.

PwC Comments

The "Upstream Associations" represent the supplier and agency associations. Suppliers are the entities that manufacture alcoholic beverages. Liquor suppliers consist of breweries, wineries, and distilleries located throughout the world. Liquor agencies are the entities that are primarily responsible for inventory management, sales, and product promotion.

The responses from the three upstream associations were consistent in that all believe that "status quo" is not an option. Each group offered suggestions on how the system could be improved. The underlying theme of all suggestions was that "free market conditions" should take precedent over "fairness and equity" to retailers whereby suppliers and agents would have a greater control over how their products were moved through the supply chain (e.g., who distributed them). The implications of greater supplier control are that product selection and standardized pricing could be impacted.

6.2.1 Spirits Canada

- The Alberta supply chain should be amended to allow for additional flexibility.
- Free market forces must be deployed to ensure proper market signals (rewards and penalties) are sent to market participants.
- Service provider rate sheets should reflect the economic realities of their business operations (i.e. their cost drivers) and should strive to minimize any cross-subsidization between products.
- One option would be the establishment of additional authorized service providers. This could range from a wide-open system (as in retail) where for a nominal fee, any operator meeting minimal standards would be allowed to warehouse and distribute liquor products in the province.
- A more limited option, would foresee the AGLC authorizing a limited number of additional service providers based on a more stringent review process (similar to the one used initially to authorize Connect). In such an option, suppliers could tender their business to any such authorized service provider based on the value/cost/service standard offered by each competitor.
- Multiple authorized service providers would help unleash market forces and require service providers to offer the best services at the best price. In addition, it may be that in a more open system, with more competition, some differentiated service options may be made available.
- If the policy decision is taken to continue with a single-service provider option, the key question of how service fees will be determined needs to be addressed. In such an option, the monopoly service provider becomes akin to a utility providing essential services to businesses. As such, the fee schedule for services would need to be based on an actual system costs (with any profit margin clearly identified) with no cross subsidization between competing products.
- LTOs are just one business tool that you use to drive your business. We do not support the concept of imposing a fairness principle on to LTOs so that everybody gets to participate.

6.2.2 Canada's National Brewers

- The Connect Logistics Services (CLS) warehouse and distribution system has not adequately responded to the realties of the supply chain complexity and demand.
- CLS will not be capable of meeting these ongoing challenges in the future at a reasonable cost and structurally efficient model without some change.
- The system does not need drastic overhauling, but rather needs updating to reflect the current and future economic, market and distribution infrastructure realities within the province. Further the system needs a clear understanding of the principles that are intended to produce outcomes, but not wholesale change.
- The result of the current situation is a lack of confidence in the system and the risk of having to support unsustainable costs in the future and regular disruption in the supply chain.
- One remedy to the current circumstances and future pressures of demand and supply chain complexity would be to allow Molson, Labatt and Sleeman breweries to evolve their current

service to include the distribution of import brands under their ownership, license or agreement through the Alberta based distribution entities currently operating on their behalf.

- The movement of import brands to Sokil and BDL will have several significant impacts that will improve the stability of the supply chain and support consumer demands.
- The proposal is a natural evolution of the policy in Alberta with the added benefit of alleviating labour, warehouse and cost pressures from CLS and allowing them to focus all of their attention on the more complex business of spirits and wine distribution.
- It is an extension of the current policy allowing domestic Alberta brewers with perishable products, the ability to sell, market and distribute products owned or under license by the brewer.

6.2.3 Beverage Alcohol Importers Council of Alberta (BAICA)

- A system must (be) put into place to hold the agents, freight forwarders and the warehouse accountable for better communications. In-bound shipment must be recognized by CLS far enough in advance of receipt, so they can prepare the space as well as the staff to handle the receiving duties.
- We are suggesting that the industry assigns a 'WATCHDOG' type entity to audit each and every link of the liquor supply chain. This initiative should come from ALIRT and report to the stakeholders on a regular basis. The stakeholders would have a report card filed by the 'Watchdog' and these report cards would be reviewed at the ALIRT meetings.
- We are also suggesting that CLS be given strict service guidelines, in which to follow; up until now CLS has set their own service levels. We must set minimum expectations that will satisfy both the downstream and upstream sectors. These service standards should be charged for accordingly.
- Having a competitive environment within the warehousing/distribution system, will allow for everyone to pay for the services they wish to use.
- LTOs need to be controlled by the suppliers, not the retailers. This is a tool used by agents to reward our customers. LTOs are budgeted for and quantities have to be capped. As long as the regulations are followed, this needs to continue as it has in the past.
- Our membership is asking for more control over the inventory that we own.
- If CLS is going to have to work under a new set of guidelines, we suggest they be prepared to offer the ability for all licensees to order bottle stock and lower minimum orders. These services can demand extra fees.
- We are suggesting that contacts be put in place to deal with slow moving products. We respect the need for these products to be treated differently than the faster moving products.

6.3 Downstream Association Responses

This section provides a summary of the responses received from the five downstream associations. The comments included for each stakeholder are taken directly from written submissions.

PwC Comments

The "Downstream Associations" represent the retailer associations. Unlike the upstream associations, the general consensus of this group is that "fairness and equity" to retailers must be maintained (i.e., equal access to LTOs, standardized wholesale pricing, postage stamp delivery). The suggestions centered on fixing the existing system rather than whole scale changes to the underlying principles of privatization.

Each group offered suggestions on how the system could be improved. Many of the suggestions are consistent with the upstream associations (e.g., better planning, better communication). The one area where the two groups are in fundamental disagreement is on the issue of LTOs.

6.3.1 Alberta Liquor Store Association (ALSA)

- For the past thirteen years this model has worked well.
- ALSA believes that four overarching elements are the root cause of the disastrous 2006 warehouse mess.
    - Structural – A warehouse originally designed to handle 800,000 cases attempting to service 2,000,000 cases. Following the "fall from hell" in 1997, major structural changes were implemented and significant improvements were witnessed. These structural changes permitted CLS to handle approximately 1.8 million cases, not the current 2.3 million that the robust Alberta economy has brought. The absence of a predicable and consistent distribution operation, compounded by massive short ships and stock outs, compelled retailers to radically modifying their traditional business model and acquire significantly higher inventories in fear of having no product to sell to their customers particularly for the pending Christmas season.
    - Regulatory – Notwithstanding that the GLA (Gaming and Liquor Act) and GLR (Gaming and Liquor Regulation) confirm that the AGLC have a fundamental role in the supply chain management, gaps exist and require prompt attention. In addition, we propose that an ALIRT supply chain expert be retained. Not only to deal with the upstream and downstream sectors of the industry, but to ensure the warehouse/distributor rate structure is fair and reasonable and market competitive.
    - Coordination – The past seven months clearly confirmed that reliable and accurate information was absent. Fundamentally, all sectors demonstrated that accurate and reliable supply chain information is critical to ensure that facts as opposed to faults would be the key focus. The ALIRT supply chain expert would be in a position to assist in coordination.
    - Communication – Critical to success is open dialogue between the sectors that is reliable and timely.
- ALSA would vigorously oppose multiple warehousing. Notwithstanding the recent costly disruptions, we strongly support the continuation of the single warehouse/distributor model

for import beer, wine and spirits as this is the only structure that allows all our members a level playing field in accessing product.

- Smaller urban retailers too will be impacted as large operators and chains would operate their own warehouse/distribution system and unfairly gain from their ability to warehouse and distribute liquor products as part of their core business distribution system. ALSA firmly believes that multiple warehousing is not an option.
- Should it come to pass that multiple warehousing for import beer, wine and spirits be permitted, then we acknowledge that grocers, chains and others would move to establish their own bonded warehouses and topple the Alberta Model thereby eliminating the level playing field, terminating postage stamp freight rates and dismantling the Alberta Model.
- Efficiently managing supplier inventory is fundamental for a successful single warehouse/distributor that is based on the Alberta Model. Currently no one body has coordination of the inventory of adult beverages in the province. Hundreds of suppliers who store product on consignment with CLS have this responsibility and without coordination, supply disruptions are inherent.
- Over time, LTO's evolved from a seasonal event to a key operational reality for the industry. Any modification to the LTO's structure requires considerable consideration and detailed discussions between the upstream and downstream partners. Recognizing that it is the upstream sector that exclusively controls the levels of inventory that is put on LTO. Once that allocation is subscribed the remaining inventory is offered in the next buying period.
- The overarching and fundamental principle must be equitable access to ordering. We propose that an LTO framework be negotiated between the downstream and upstream sectors.

6.3.2 Canadian Council of Grocery Distributors (CCGD)

The CCGD did not express a preference for one service delivery model over another. Rather they provided comment on three different potential options.

Option I: Maintain Central Warehousing Function:

- Maintain CLS as the sole central warehouse and distributor with the following changes:
- Implement inventory turn and on-hand benchmarks with surcharges to the supplier either for failing to meet turn requirements or failing to keep adequate inventory on hand to meet demands.
- Segregate slow and fast moving SKUs with dedicated building for each allowing the fast moving environment to concentrate on rapid processing of volume orders while the slow moving facility concentrates in storing and selecting smaller quantities of more specialized product.
- Increase the minimum order quantity to 100 cases or two pallets to maximize efficiency in order selection and shipment.
- Implement a de-listing process so that dud product can be removed from the warehouse environment.
- Implement more rigorous policies for scheduling on inbound loads to allow the CLS traffic department to maximize dock space, warehouse labour and alleviate congestion.

- Discontinue inter-board shipments during peak volume periods and as long as service issues continue.
- Discontinue the practice of renting warehouse space to retail customers for the purposes of storing purchased product and contract with a separate third party storage facility to provide this service off site.
- Add additional warehouse space as requirements and geographic demand dictate.

Option 2: Allow for Supplier Distribution Co-operative:

- Similar to the Brewers Distributing system in Alberta the AGLC may wish to consider allowing suppliers to establish warehousing and distribution co-operatives for the sole purposes of distributing their products directly to the retail customers and licensees. The co-operatives would have to operate under the same policies and procedures as the CLS operated warehouse and would be required to service the entire province. Since these co-operatives would distribute the product lines of its members it would not be in direct competition to CLS and would serve to move some of the volume from the CLS facility to a new warehouse.
- Suppliers could choose whether to join a co-operative distribution system or maintain their existing distribution arrangements through CLS. For retailers it would add the complexity of having to deal with another distributor, but permitting the creation of an additional distributor would improve distribution capacity in the province while decreasing pressure and volume on the existing infrastructure.

Option 3: Completely Privatize the Wholesaling Function and Open the Market to Competitors

- Under this scenario the AGLC would completely privatize the wholesaling and distribution function currently provided by CLS. AGLC would retain control of setting policy, by which these distributors/wholesalers would have to function. Specific policy consideration such as equal pricing to all customers, LTO requirements, and distribution requirements (whole province vs. distinct territories) could be established by the AGLC. Distributors would be able to decide which products they carry and how best to serve their respective markets, and would compete for clients based on service level and product selection. Distributors would be compensated on a flat rate per case which builds in an incentive for efficiency.

6.3.3 Canadian Restaurant and Foodservices Association (CRFA)

- One of the strengths of Alberta's privatized liquor distribution system is the variety of products available to customers through retailers and licensees. While limiting the number of products would increase turnover, create more space in the warehouse and decrease the chance of picking errors, CRFA feels that limiting the number of products would weaken one of the strengths of the Alberta system.
- AGLC and CLS must do a better job forecasting demand and planning for spikes in volume. There must be performance incentives in CLS' contract to ensure service levels are maintained and delivery times are guaranteed during busy peak times. Given the monopoly CLS enjoys there is no risk of losing market share due to poor service. Why would CLS increase their costs by providing more staff to ensure service levels are maintained when there is no risk of losing customers? In the absense of competition AGLC must ensure CLS

maintains service and delivery standards without passing on additional service costs to retailers and licensees.

- Rather than limiting the number and variety of products available a better solution would be to implement different delivery timelines for high volume products versus low volume products. If warehousing lower volume products separately increases efficiencies without increasing costs we would support that option. The main issue for licensees with respect to deliveries is that delivery times are predictable and that the products delivered accurately reflect what was ordered.
- Licensees can plan for and would accept slower delivery times for low volume products as long as they have confidence that products ordered will be delivered when promised.
- Licensees would also like to see the 25 case minimum order quantity reduced to 10 cases for low volume high priced products.
- CRFA agrees that the current method for placing orders for LTO's needs to be adjusted. CRFA received a few different suggestions to improve LTO ordering to ensure more product is available. Order limits tied to the retailer/licensee's historical ordering patterns would help ensure that a few large retailers are no longer able to order all available LTO product. Another suggestion would be to remove LTO time restrictions. Suppliers could also be forced to ensure LTO supply meets the demand by offering a product price guarantee during the LTO promotional period.
- One solution to warehouse storage times is to separate the high volume versus low volume products as mentioned earlier. Another solution could be to allow wine agents and others with slower moving products to simply process their orders through the main warehouse transferring their products to their own warehouses. Allowing agents to warehouse and direct deliver their products after being processed at the AGLC warehouse would significantly reduce warehouse time and space.
- One significant issue the discussion paper did not address is a cost benefit analysis of the problems and possible solutions. It is difficult to recommend solutions without understanding the current financial situation relative to the costs and benefits of the proposed solutions. Stakeholders need to be provided with the appropriate financial information to assess the costs and benefits of the various solutions outlined in the discussion paper.
- CRFA confirms its support for the current "postage stamp" delivery rate system.

6.3.4 Alberta Hotel & Lodging Association (AHLA)

- Since the implementation of privatization of the liquor industry, our members have received excellent service from Connect Logistics Service (“CLS”). However, since the summer of 2006, the supply chain disruptions that have occurred have had a serious and negative impact on our members.
- We believe that ultimately, AGLC is responsible for recognizing, forecasting and planning properly in this dynamic Alberta environment. Subsequently, as distributor, CLS needs to prepare and respond with adequate investment in information, warehousing, and handling systems.
- As the mandated regulator, going forward AGLC must be more responsive to stakeholder needs and the economic climate. Performance measures and benchmarks must be implemented, enforced and reported, and the AGLC must consult with industry on a timely

basis, set transparent rules, and monitor the supply chain to ensure efficiencies and effectiveness. An emergency plan must also be put in place to deal with any future distribution delays.

- A level playing field is paramount to this system, and the fact that no liquor licensee pays a higher price or lower delivered price for liquor products due to geographical location is of utmost importance. Our members invested considerable capital into this industry based on that mandate, along with all other stakeholders, and expect that these fundamental principles be adhered to going forward. Fairness and transparency is a critical success factor!
- The flat rate “postage stamp” delivery model must also be maintained as a fundamental principle of Alberta’s supply chain model. However, the amount of the flat rate must be adequate for CLS to provide the expected level of service. AGLC must manage the degree of any such change, as price is still paramount to the consumer, and consumers are, compared to other provinces, already paying more for certain liquor product. To ensure competitiveness, the AGLC should conduct an annual performance review of CLS comparing costs and key performance objectives with benchmarks from other leading (best-in-class) warehousers in other industries and jurisdictions. If performance objectives are not being met then the AGLC should take the appropriate measures to ensure compliance and/or terminate the contract with CLS.
- The current LTO system is neither fair nor equitable, and does not permit a level playing field. Large retailers are afforded the first opportunity to purchase the product and have the ability to purchase all or most of it (i.e. on Friday order dates). Accordingly, perhaps smaller retailers should be permitted to order first.
- We propose benchmarks be put in place so that the distributor and other stakeholders in the supply chain are accountable for their performance. If a supply chain emergency occurs again, then the responsible parties could be better held to account.
- We believe that the warehouse should be of sufficient scope to reduce the unnecessary handling of product in the picking process, and should be able to accommodate scheduled inbound shipments. If more warehouse space is required to store saleable product, that space should be acquired immediately.

6.3.5 Alberta Independent Liquor Retailers (AILR)

- Connect Logistics can either persist in the belief that the only way to increase capacity is to invest capital and human resources or they can take the preferred approach of continuous improvement. The result will be measured not in terms of assets (equipment, staff) but in continuing sustainable reductions in waste and non value efforts as well as the dollar figure that retains the bottom line, and can bring reduction in the case delivery charge to the industry.
- Periodic Performance Review should be done regardless of the timeframe of the contract; regular feedback is critical to a successful program. Regardless of who, big or small, make the feedback process part of the agreed upon criteria to ensure the outcome is as good as it can be. The following criteria could be used to review applications for new products:
  - Project(ed) consumer demand.
  - Sales performance in Alberta.

  - Product price and continuity of supply
  - To align the inventory plan with demand.
  - To constantly review and analyze demand data at all levels of the supply chain including the customer level.

- The LTO problems and availability to small retailers can be resolved. We suggest an annual promotional calendar, which outlines 18-20 promotional turns within the fiscal year. This would be supplied to AGLC by the supplier for approval for the coming year. ie. AGLC approves these annual promotional calendars in conjunction with Connect Logistics, to ensure that suppliers have enough product to supply the market, and that Connect Logistics has enough warehouse space to facilitate the product This promotional calendar should be posted on the Connect Logistic web site for all retailers to access. If computer access is an issue for some retailers then LTO calendar should be faxed to them.
- To meet the Alberta regulations each supplier will have to bring in enough inventories to satisfy the demand as per the sales for last year plus 10%. Everyone then has the opportunity to purchase LTO's. There should be no storage at Connect for bought products.
- This regulation could be implemented on the top 500 skews being distributed by Connect Logistics, and the smaller suppliers to be left as is for now. This will then give the AGLC Board enough data to forecast a LTO regulation for suppliers in the future.
- The Connect Logistics warehousing problem could have been fixed if they had used the CPFR program. Currently most of the big warehouses use this program to eliminate the problems that we have encountered. CPFR is a collaborative, planning, forecasting and replenishment program under which suppliers, and agents jointly with connect develop sales forecasts, track and monitor forecasts vs. actual sales. CPFR will ensure a continuous stream of products to meet the demands for Alberta retailers, it will improve forecast accuracy also will help reduce stock outs and back logged inventories at Connect.
  - Proactively react to inventory issues. Note how your suppliers are shipping. Confirm receipt dates with suppliers.
  - Follow up with suppliers to resolve issues in a timely manner.

6.4 Discussion Paper – Responses to Questions

6.4.1 The External Context

Stakeholders were asked a series of questions about the impact of external factors on the supply chain challenges faced over the past 6-12 months. A summary of their responses is included in this section.

1. ***To what extent are the issues surrounding the liquor supply chain the result of external factors such as the economy, population growth and increased demand? To what extent are the issues the result of factors specific to the supply chain itself?***

   Of the 28 respondents that answered this question, only 2 believe that external factors contributed to a greater extent to the supply chain issues. The vast majority believes that factors specific to the supply chain resulted in the problems that have occurred in the past 6-12 months. This is further broken down as:

   Sixteen out of seventeen upstream respondents (i.e., agents, suppliers, freight forwarders) believe the issues are the result of supply chain issues.

   Nine out of ten downstream respondents (i.e., licensees, retailers, associations) believe the issues are the result of supply chain issues.

Some sample comments included:

Upstream Associations

"The breakdown in the supply chain was largely the result of the sole authorized service provider not adequately planning for and managing the changing circumstances in the external environment. The current model displayed a lack of flexibility and responsiveness to the external business environment"
Spirits Canada

Agents/Suppliers

"Yes, the external factors are a factor in these issues. However I would suggest that these factors are not the major concern".

"Identifying the external factors of the economy, population, disposable income and labour market, as the most plausible causes of pressure on the existing liquor supply chain is probably quite appropriate"

"Connect Logistics may have failed to synthesize the developments in Alberta's emerging market and therefore, did not anticipate the effect it could have on its system and processes. Once the issues began to be experienced, reaction and resolution to the increased demand took too long to address."

"…do not believe external factors are the main reasons for CLS' problems"

"The problems experienced with the liquor supply chain were due to the failure by CLS to plan for, and anticipate the need to deal with the external factors (economy / labour / demand)."

"It appears that there was no plan in place to cope with expansion of the industry beyond the current turnover of cases."

Downstream Associations

"…we do not accept as the sole reason that the recent supply chain disruptions are exclusively as a result of a robust economy."
Alberta Liquor Store Association

"While external economic and labour factors have added pressure to the liquor supply system those pressures are manageable through proper business planning and forecasting."
Canadian Restaurant and Food Services Association

Independent Licensees

"I would be more likely to blame the external issues. Too much volume will overwhelm any business, no matter how well or poorly they were prepared to begin with. The fact that CLS was able to keep functioning at all is a minor miracle."

"The real problem is that there was a lack of noticeable internal preventative action taken to compensate for the external pressures on the industry."

PwC Comments

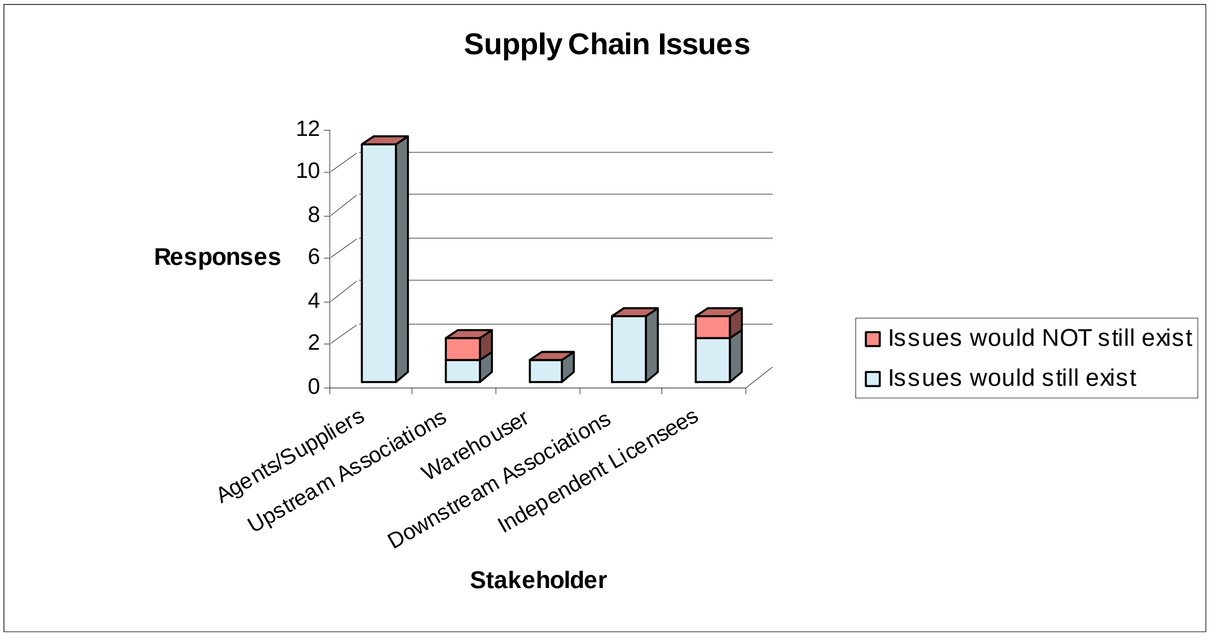
The current system does not explicitly define who is responsible for long term planning. The "Appointment" of Connect Logistics (CLS) is not explicit on this point, indeed the nature of the Appointment does not offer CLS security of tenure or even exclusivity against which it can make longer term capital investments

Best practice in supply chain management operations work on a collaborative planning model which reaches as far as possible into both the supply and demand sides of the supply chain. The current model does not establish that any of the supply or retail participants in the supply chain provide any of the data needed to establish a collaborative planning process. There is also no clarity on how prioritization decisions will be made in the event of the level activity exceeding capacity at peak periods. It is generally not efficient to establish capacity for the peak. For a collaborative supply chain model to work there must be:

- agreement on what data is to be supplied by when and in what format;
- agreement on how prioritization decisions are made and by whom; and
- acceptance by all parties of the decisions made.

2. *If issues surrounding the strong economy, labour shortages and increased demand did not exist, or if circumstances changed, would there still be challenges with respect to warehousing and distribution in Alberta?*

Of the 20 respondents that answered this question, 18 believe that challenges would still exist with respect to warehousing and distribution in Alberta.



Some sample comments included:

Upstream Associations

"Single warehouse tends to be less efficient and more costly without competitive pressures. Importers and customers have no choice, but to use the monopolistic system."
JF Hillebrand

Agents/Suppliers

"Yes! Having multiple warehouses is inefficient, having old equipment that is not able to handle the increase of inbound and outbound traffic, not having updated computer software that allows better communication between AGLC, Connect Logistics and Agents."

"Yes. The fundamental question is whether the existing system can cost effectively support all the products listed and whether liquor products will continue to cross subsidize each other for the greater good of the whole system."

"Main reasons for these problems is that CLS has a monopoly and has no competition."

"The challenges that need to be addressed are as follows: efficiency of the CLS warehouse site, inventory location within the warehouse, efficiency of receiving, efficiency of distribution, the quality and quantity of machinery, and finally, their attitude towards the primary customer (i.e the Agents)."

Downstream Associations

"There would still be challenges especially around peak times as it appears CLS is not prepared to handle order spikes in volume."
Canadian Restaurant and Food Services Association

PwC Comments

The existing warehouse facility has been upgraded significantly since privatization and handles significantly more than its original design volume. There is now a need to develop a longer term plan. Determining how to go forward in the long term will need to be a carefully considered process with a strong supporting business case. There needs to be clarity as to who is making any investments in additional space regardless of the number of locations.

Meeting the needs of the system for 2007 and 2008 will need a short-term, tactical action plan as setting up a new facility with all the required system links and processes is a significant effort.

3. ***Given the impact that external drivers, such as economic conditions and population growth can have on the liquor supply chain, how can we better prepare for the future?***

Some sample comments included:

Upstream Associations

"Free market forces must be deployed to ensure proper market signals (rewards and penalties) are sent to market participants"
Spirits Canada

"Extend the opportunity to industry to open a second warehouse and provincial distribution facility in Alberta."
ContainerWorld

"There needs to be improved communication and transparency between the links in the liquor supply chain."
Beverage Alcohol Importers Council of Alberta

"Major agents/importers should be canvassed for import projections…"
JF Hillebrand

Agents/Suppliers

"…build capacity and flexibility into the existing system"

"…the AGLC and Connect need to do a better job at planning for the future."

"AGLC must create a free market warehouse and distribution model to ensure the supply chain can adapt to change."

Warehouser – Connect Logistics

"We need to plan for the future today and we need to be aggressive in the assumptions we make around provincial growth so as to not be surprised in the future."

Downstream Associations

"There must be performance incentives in CLS' contract to ensure service levels are maintained and delivery times are guaranteed during busy peak times"
Canadian Restaurant and Food Services Association

PwC Comments

Given the lack of time before Alberta is into the higher volume 2007 season and the need for a long term study it is unlikely that an alternative solution can be implemented in time for the summer beer/cooler season or Christmas 2007. Consideration should be given to a multi-party planning project for 2007 and 2008 using the existing vendor.

If an agreed forecast and plan can be prepared for 2007 and 2008 consideration should then be given to the setting of performance standards for all participants in the supply chain.

6.4.2 The Supply Chain

This section focused on stakeholders' understanding of the different roles and responsibilities of the different groups. A summary of their responses is included in this section.

4. Are the roles and responsibilities of all participants in the supply chain clear? Are all the parts working together effectively? How could this be improved?

Of the 18 respondents that answered this question, 15 believe that roles of the different stakeholders are well understood. However, only one respondent believes that the different groups are working well together.

Specific comments included:

Upstream Associations

"The roles and responsibilities of the participants are clear, although they are working together, it could be more effective with better lines of communication"
Beverage Alcohol Importers Council of Alberta

"The roles of the entities in the supply chain are clear to those directly involved in the transportation chain. It is not clear to the agents, retail sector or end customers."
JF Hillebrand

Agents/Suppliers

"The roles are clear however responsibilities are not"

"Roles and responsibilities of all participants in the supply chain are clear but all parts are not working together effectively"

"No, roles and responsibilities are not clear. No, all parts not working effectively."

"Roles and responsibilities seem to be clear under the current regime, and participants seem to cope with each-other and with the existing regulations. The problem at hand is apparently warehousing."

Warehouser – Connect Logistics

"While the roles are clear, the required disciplines and accountabilities to the model are not."

Downstream Associations

"The past seven months have confirmed that neither are the parts working together nor are the roles and responsibilities of the participants clear."
Alberta Liquor Store Association

PwC Comments

The current system does not explicitly define who is responsible for long term planning.

Best practice in supply chain management operations work on a collaborative planning model which reaches as far as possible into both the supply and demand sides of the supply chain. The current liquor distribution model in Alberta does not establish that any of the supply or retail participants in the supply chain provide any of the data needed to establish a collaborative planning process. There is also no clarity on how prioritization decisions will be made in the event of the level activity exceeding capacity at peak periods.

5. ***Given that, currently, no one entity is in control of the entire liquor supply chain, how can each part work together to ensure a successful outcome for the supply chain as a whole, not just for the part that a particular entity (e.g. an agent, freight forwarder, warehouse, etc.) is responsible for?***

Specific comments included:

Upstream Associations

"Clearer lines of communication…"
Beverage Alcohol Importers Council of Alberta

"Good planning and communication"
ContainerWorld

"Create and maintain Begin to End visibility for all entities involved on: demand/inventory/orders/depletion/"
JF Hillebrand

"transparency on Connect operations and practices would better allow clients to feed into the overall process in the most effective manner."
Spirits Canada

Agents/Suppliers

"…the ability to measure and manage parts of the supply chain"

"Respect is needed in this industry!"

"…supply chain should be controlled by the agent."

Independent Licensees

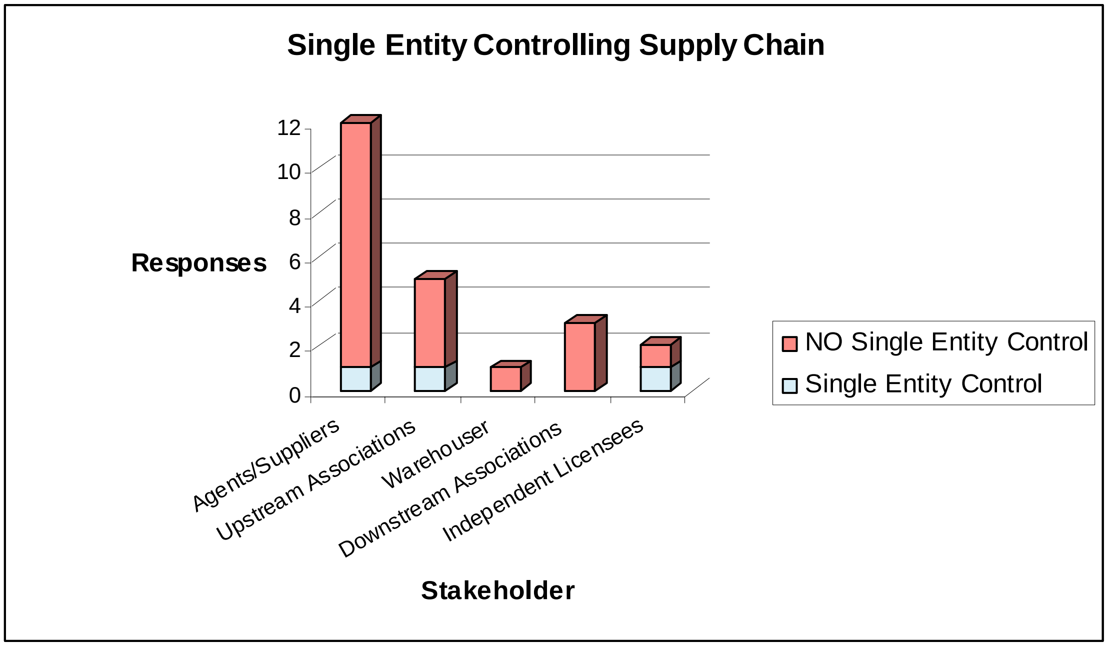
"By treating all stores equally and probably by eliminating the ability of larger stores to warehouse product at Connect."

PwC Comments

Determining who has final responsibility for managing and decision making in the supply chain does not have to mean that there is a single decision making body. There are numerous options as is demonstrated by the supply chains for other consumer products. A single decision maker (which could be industry based) is one option for consideration.

6. *Would there be merit in having one entity coordinate the entire liquor supply chain? What entity could do this? What roles and responsibilities would this entity need to have? What implications would this have on the free market model used in Alberta?*

Of the 23 respondents that answered this question, only 3 believe that one entity should coordinate the entire supply chain. However, there was NOT consensus on who that one entity should be.



Specific comments included:

Upstream Associations

"We don't need more rules and controls. What we need is the ability to regulate ourselves. It is our recommendation that the industry assigns a 'WATCHDOG' type entity to audit each and every link of the liquor supply chain."
Beverage Alcohol Importers Council of Alberta

"There would be merit in creating a "Logistics Central" and separate this from commercial issues".
JF Hillebrand

"We do not support the appointment of a single entity to control the supply chain."
Canada's National Brewers

Agents/Suppliers

"Absolutely not…this is a free market"

"This could be done by a single entity but it would place unnecessary restrictions on stakeholders and not enhance the free market model."

"…the board is ultimately responsible for the quality of the service of the company that they chose to contract the service to. I believe that the obligations of the board are significant considering how heavily regulated and taxed this industry is."

Downstream Associations

"…the AGLC can be instrumental in the coordination (of) the supply chain, but we do not agree that the AGLC should directly involve itself in the day-to-day activities. Coordination by the AGLC must be limited to consultation with the industry prior to establishing the framework, setting transparent rules, and monitoring activities and if non-compliance occurs, rigid enforcement."
Alberta Liquor Store Association

Independent Licensees

"Yes there would be merit in having one entity coordinate the entire liquor supply chain."

PwC Comments

There is a strong view that coordination (not control) of the supply chain is desirable. In other jurisdictions in Canada typically the regulator undertakes that function. There are, in the consumer products world, other models. The most prevalent model is where the supply chain is run by retailers with each retailer controlling their own supply chain either through their own facilities or through wholesalers. Retailers are by definition closest to consumers and have the clearest perspective on setting priorities based on consumer preferences. The other model is for suppliers to control the supply chain as is the case for the distribution of locally produced beer in Alberta. Both models have pros and cons which need further consideration, especially as alcoholic beverages are controlled to ensure social responsibility and to ensure the flow of the associated revenues to the province.

Any coordination of the supply chain does mean that there has to be agreement on the data requirements, formatting and timing as well as the "rules" for resolving conflicts at peak periods and for future planning.

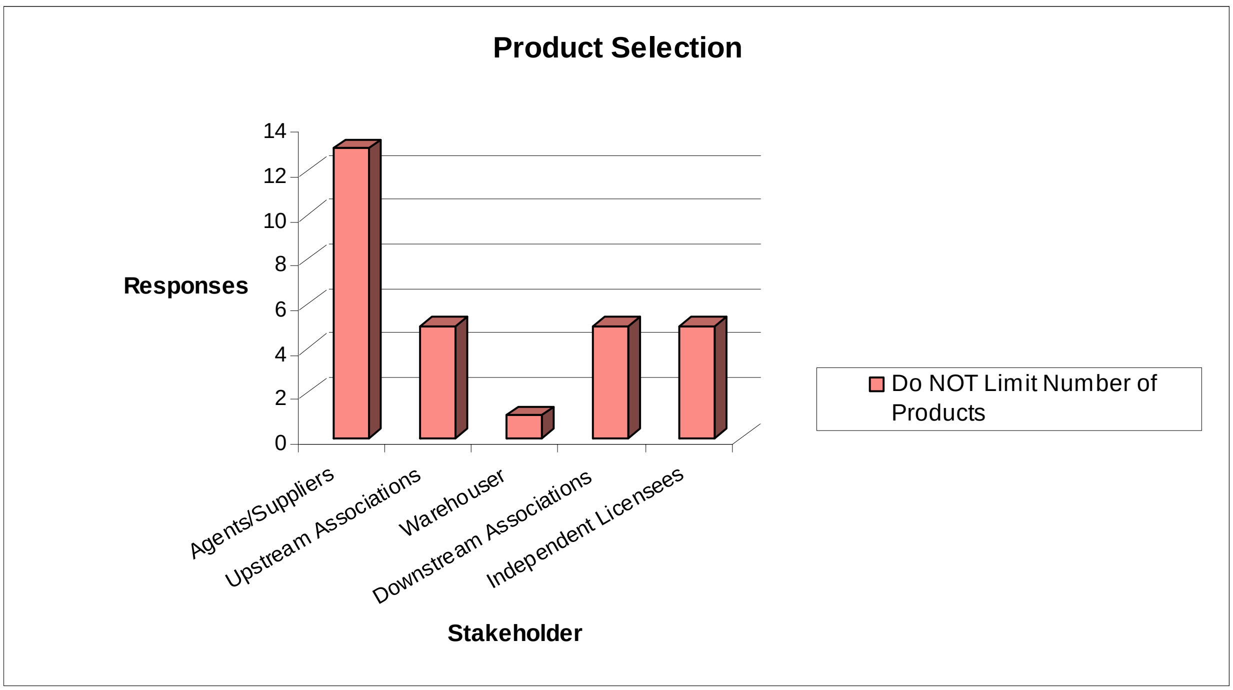
6.4.3 Issues Surrounding Liquor Supply Chain Management

The previous section described the key areas in the supply chain management process and the roles and inter-relationships of these parts. This section focuses on the current situation, including the recent trends and developments that have impacted the liquor supply chain in Alberta.

6.4.3.1 Products and Inventory

7. ***Albertans have access to a wide range of liquor products at the wholesale level, where the market decides which products are ultimately available. Some have suggested that the number of different types of products available to be sold is affecting the level of service offered, and that a limit to the number of products warehoused and offered for sale would be beneficial. Others have indicated that slow moving products should be segregated (perhaps in a separate warehouse) and be available only at reduced service levels. To what extent would you agree that the number of liquor products should be managed? What do you see as the benefits and challenges of limiting the number of products available? How effective do you think limiting or managing the number of products would be in solving the issue of ensuring effective and efficient delivery to liquor retailers?***

None of the 29 respondents that answered this question believe that limits should be placed on the number of products available for sale in the province.



Specific comments included:

Upstream Associations

"The number of liquor products available should be determined solely by market force"
Spirits Canada

"…there should be no maximum limits placed on products allowed into this market."
Beverage Alcohol Importers Council of Alberta

"We do not support limits to listings or limiting the number of skus offered for sale in Alberta; this is one of the strengths of the market. We do support however financial disincentives to stock marginal skus or brands with the financial onus placed on the agent or supplier to accept the total cost of handling storage and inventory."
Canada's National Brewers

"…consumers have become accustomed to such a wide product selection – further, they are unaware of the costs which become inherent with such a high content of non moving SKU's. If it was any other industry the buyer/seller would weed out the slow moving products from his catalogue."
ContainerWorld

Agents/Suppliers

"Limiting the number of products is not an option; we are a 'free" market."

"…there should be no limits to products."

"What makes the Alberta market the best in Canada is the product choice/variety."

"Alberta is one of the richest provinces in the western hemisphere, and Albertans deserve as many choices as they can afford."

"Most private businesses would recognise that there are limits to the amount of work they can perform in a timely and effective manner. Often, private business says no to additional business if they believe that by taking on more business, it would adversly affect the service provided to the current customers. The Board and CLS have an obligation to take steps to insure that the service provided to current customers is not adversly affected by new customers. If these steps include a freeze on new listings until such time as the service can be resonably guaranteed, then those steps should be taken, and the Board should have the courage to make those decisions."

"The "come one come all" policy of the Alberta model is historical, and revisions or changes to that policy should reflect the ability of the Board to ensure the maintenance of the service."

"More penalties on the agent with a defined time line on products should be introduced"

"It sounds to me like the Board is abdicating its responsibilities as the regulator of alcohol in the province. As stated above, the Board has the duty to provide service for fees. Either reduce the fees with reduced service, or ensure the service."

Warehouser – Connect Logistics

"We do not support imposing product limitations. Rather, we support building a network to support the desires of the manufacturers and retailers with recognition for the tradeoffs of a broad product selection on cost and service."

Downstream Associations

"ALSA would oppose any move to adopt a centrally planned model that would be established a selection committee to determine what products would be available for sale to Albertans. The wide selection that Albertans' enjoy is a fundamental of privatization and must be maintained."
Alberta Liquor Store Association

"One of the strengths of Alberta's privatized liquor distribution system is the variety of products available to customers through retailers and licensees."
Canadian Restaurant and Food Services Association

PwC Comments

There is no fundamental reason to control the number of SKUs in the system as long as there is sufficient demand for the products for an Agent/Supplier to decide to import the product. The more products, however, the more complexity will occur in the system.

In accepting a large number of SKUs it is important to recognize the true costs of receiving, storing, picking and shipping in small quantities, often with extended storage periods. The current rate structure used by CLS does not appear to differentiate for all these different activities and the differential costs involved. The rate structure does not appear to reflect the likely costs of small volume SKUs passing through the system and therefore it does not apply the normal commercial discipline which would ordinarily tend to control a proliferation of SKUs. This comment is not intended to suggest that the number of SKUs should be controlled, rather that the true costs should be reflected and that the investments required to process small volume SKUs can be made based on the number after "commercial" rates are applied.

8. ***If product limits were introduced, who would manage these limits, and what criteria would be used to manage these product limits? What consumer reaction would be expected if such a measure were implemented?***

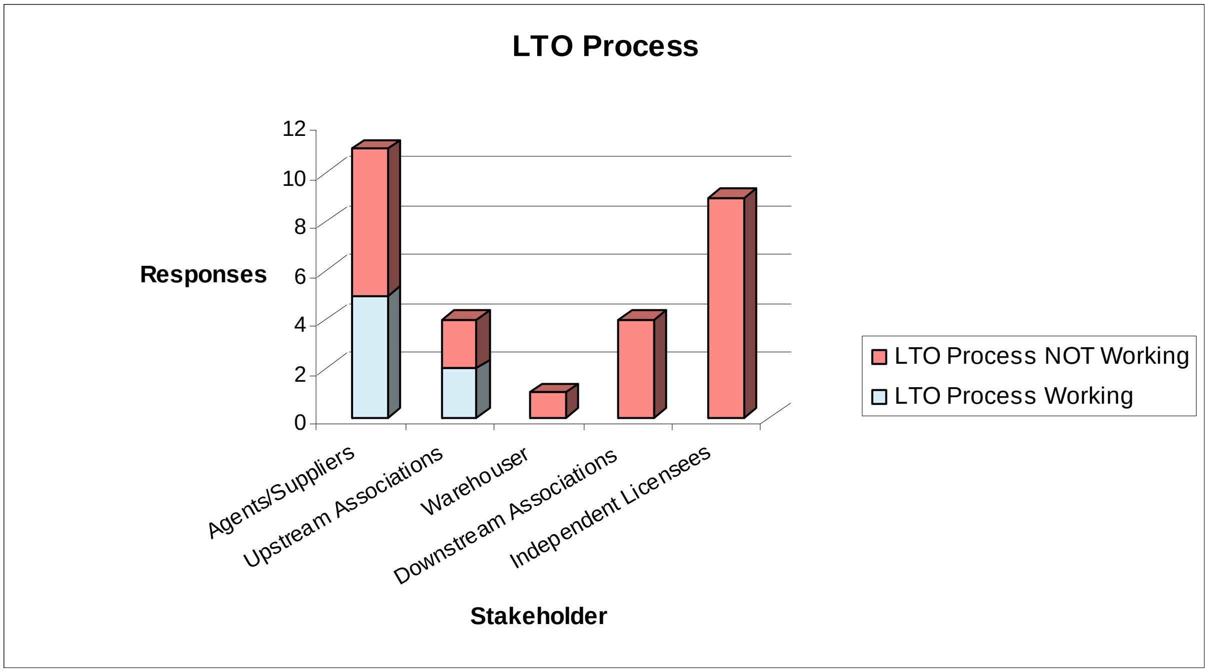
None of the 29 respondents that answered this question believe that limits should be placed on the number of products available for sale in the province. However, 18 of 24 respondents believe that a better job could be done managing the products that are available.

PwC Comments

As stated above, there is no fundamental reason to control the number of SKUs in the system as long as there is demand for the products. The more products, however, the more complexity will occur in the system. That complexity should be reflected in the costs applied to each SKU. The most logical approach is to charge based on the volume of activity and the amount of handling and storage involved. This will provide an incentive for Suppliers/Agents to ensure that they have a business case for the products that they wish to sell in Alberta, especially small volume specialty products which appear to be paying less than the full costs associated with them under the current rate schedule. Comments supporting this reality were made during the interviews completed for this project; however a quantitative analysis has not been tabled by CLS.

9. ***Some have suggested that the current method for placing orders for limited time offers (LTOs) creates an unfair situation that works to the advantage of larger retailers. Do you believe this is the case? If so, what would you suggest to improve the situation to ensure a level playing field for all licensees?***

Of the 29 respondents that answered this question, only 7 believe that the LTO process is working (all 7 were agents or suppliers).



Specific comments included:

Upstream Associations

"Every retailer in this province has an opportunity to participate in LTO buying, the smaller or rural retailers have to develop relationships with larger or urban retailers, allowing for one of the parties to purchase the inventory and sharing with the other. We are against any type of "Rain Check" system being implemented; this would take away the 'Limited' aspect of the LTO. We do not see the method of LTOs being a problem, but would be willing to look at a system which would allow the agents to allocate the products, in question, which would allow us to limit the numbers case purchased by any one licensee, thus freeing up more inventory for more stores."
Beverage Alcohol Importers Council of Alberta

Agents/Suppliers

"Generally LTO's seem to work OK"

"We cannot allow retailers to dictate what the owner of the product (Suppliers/Agents) can do with their product."

"…little doubt that the large retailers have an advantage."

"Once you begin to set "fairness policies" you run the chance of moving away from the investment currently going on in the market place."

"No, we shouldn't let the warehouse issues drive sales and marketing issues."

"The agent/supplier should be able to set the maximum order quantity for any one customer on any single product. This is particularly true for products on LTO."

Downstream Associations

"Over time, LTO's evolved from a seasonal event to a key operational reality for the industry. Any modification to the LTO's structure requires considerable consideration and detailed discussions between the upstream and downstream partners. Recognizing that it is the upstream sector that exclusively controls the levels of inventory that is put on LTO. Once that allocation is subscribed the remaining inventory is offered in the next buying period. The overarching and fundamental principle must be equitable access to ordering. We propose that an LTO framework be negotiated between the downstream and upstream sectors."
Alberta Liquor Store Association

"…the current method for placing orders for LTO's needs to be adjusted".
Canadian Restaurant and Food Services Association

"LTO's need to be fairly distributed. Limiting quantities would be one way. This would allow smaller stores that have one order day to at least purchase some stock."
Alberta Independent Liquor Retailers

Independent Licensees

"I do believe placing orders for LTO's is very unfair. I suggest there be a limit set for all stores as a percentage of their overall business."

"Having CLS store paid LTO products for any retailer should not be an option as it is impacting the amount of space that is available for other products. Once a product is ordered and paid for it should be shipped. Leave it up to the retailer to find his or her own storage."

"…any system that allows completely equal access to the LTO opportunities is only fair."

PwC Comments

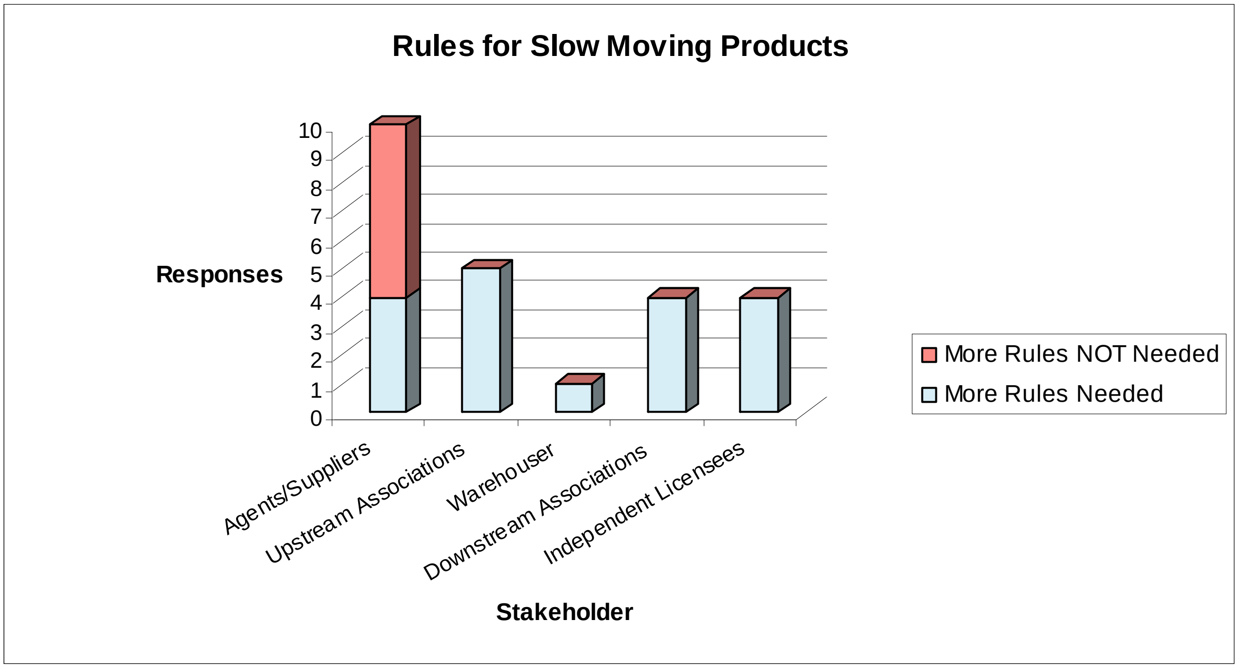
In considering LTOs it is important to recognize that suppliers offer them to meet specific commercial objectives. The AGLC can neither mandate that they are offered, cannot set the price nor influence the volume offered.

Any system which forced suppliers either directly or indirectly to sell LTO product in ways that did not meet their objectives would likely influence the number of LTOs or even lead to their withdrawal from the marketplace.

The above comments are reflected in comments which clearly show that suppliers are working with the LTO system to meet their goals which are typically aligned with supporting the larger retailers. Having said that there should be changes made which do not penalize small retailers who are not permitted to order on the day of the LTO release, but rather have to wait till their nominated order day by which time the LTO is likely "sold out".

10. Some liquor products are warehoused for longer periods than others. Should there be some rules in place to ensure that all products are moved through the warehouse, from receiving to delivery to retailers, in a timely fashion? If yes, how would you envision this working? Who would enforce these rules and how? What would be the implications of introducing such rules?

Of the 24 respondents that answered this question, 18 believe that additional rules need to be put in place to ensure that products move through the warehouse in a timely fashion.



Specific comments included:

Upstream Associations

"Products with higher turnover rates generally cost less to handle than slower moving products. Service provider rate sheets should reflect the economic realities of their business operations (i.e. their cost drivers) and should strive to minimize any cross-subsidization between products."
Spirits Canada

"In order to ensure that all products are moving through the warehouse in a timely fashion, there should be minimum standards established and pre-determined cost and penalties for not meeting these standards…"
Beverage Alcohol Importers Council of Alberta

"…as long as liquor products can be held in a warehouse for an indefinite time, there should be higher cost for slow moving products."
ContainerWorld

Agents/Suppliers

"Great in theory, however in a free market it does not work. The problem with this concept is that first time and unique products take longer to sell than mainstream product lines."

"No, it would be impossible to have all products move out in a timely fashion, some products are slow moving, but still serve a niche market; some products that need to be aged should be moved to the temperature controlled area, some products do increase in value and paying for the storage is not that much compared to the increase of the value of the product."

"Slower moving products after a designated time should be subject to significantly higher warehouse charges"

"There should be economic consequences for "failure to perform" and/or a maximum amount of time that a product can stay in the warehouse."

If the Board is inviting all players, then they should develop performance criteria suitable to ensuring that new or slow moving products do not adversely affect the service provided to current customers."

"This would be an impossible 'rule' to not only enforce but impossible to write. Who would determine what a 'timely fashion' is? Therefore warehousing products both short and long term should be part of CLS's mandate and should not be considered an exception. Implications of such rules would highly affect the availability of specialty products and high-end products. It would also adversely affect the sales of products that experience seasonal high sales and minimal sales at other times of the year."

Warehouser – Connect Logistics

"We believe that there should be some rules in place to ensure that manufacturers are maintaining reasonable levels of inventory based on sales performance and that inactive products are moved out the warehouse quickly."

Downstream Associations

"One solution to warehouse storage times is to separate the high volume versus low volume products"
Canadian Restaurant and Food Services Association

Independent Licensees

"…importers and retailers alike have a responsibility to live up to commitments to move allocated/requested products within a reasonable amount of time"

"Connect Logistics should enforce a time line to all distributors. What comes in must go out within a certain time frame."

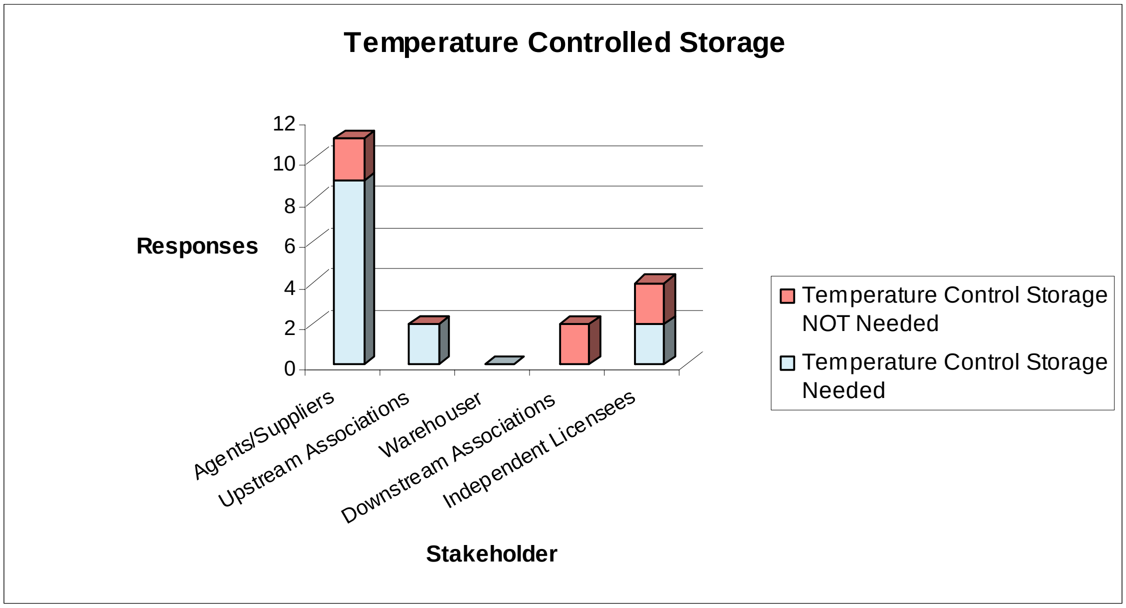
PwC Comments

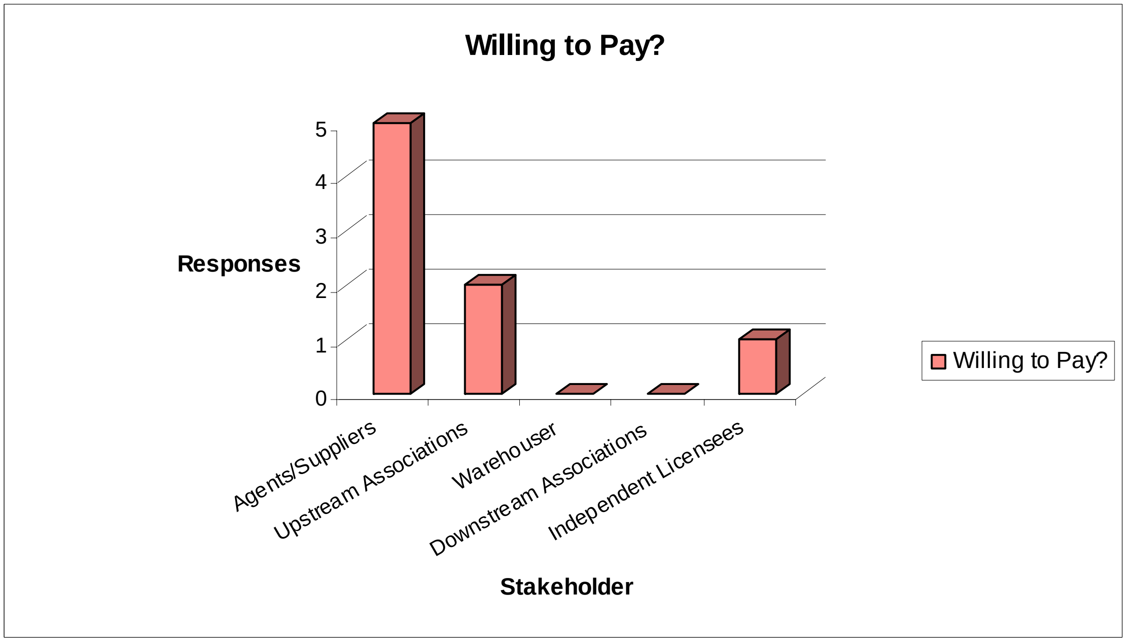
Storage of product may impact the system however it is not clear that the limiting factor at the current facilities is only volume related. The number of receiving and shipping doors is also crucial factors.

If there are rules imposed in the future on the duration of storage care will need to be taken to reflect the very different turnover rates between product types and sub groups within products. For example a volume wine turnover rate would need to be set very differently from a rare specialty product if availability of the latter is to be ensured. This will be a complex exercise if the results are not to be arbitrary as they are believed to be in some other jurisdictions.

11. Is temperature-controlled storage an issue at all? Would you be willing to pay more to have more products warehoused in a temperature-controlled environment?

Of the 19 respondents that answered this question, 13 believe that temperature controlled storage is needed (10 of whom are agents). Of the 11 respondents that answered whether they would be willing to pay for the temperature-controlled environment, 8 responded that they would (of whom 6 were agents).





PwC Comments

Temperature control is essential for some product groups and should be offered at commercial rates if at all possible to assist in the management of product quality. However, this is not a critical issue to the overall question of how to fix the problems with the existing supply chain.

6.4.3.2 Receiving Liquor Products

12. In your view, what is the key issue that has caused the backlogs in receiving at the CLS warehouse?

Specific comments included:

Upstream Associations

"The lack (or delay) in the requisite investment in receiving infrastructure and systems to handle changing market circumstances was the principle catalyst to the catastrophic system failure."
Spirits Canada

"CLS was not prepared…

- *Poor communication between the agents, freight-forwarder and Connect Logistic receiving dept.*
- *Lack of space to store the increased in-bound volume*
- *Lack of experienced staff*
- *Transportation issues*
- *Retailer panic*
- *Solutions were implemented too late*
- *CLS did not ask for HELP"*

Beverage Alcohol Importers Council of Alberta

"Planning and inability to be able to respond to the needs of the forwarders and suppliers."
ContainerWorld

"Lack of central control by any one party; Lack of alternative temporary storage-bonded CY yards, CFS facilities; No industry forecasting available to put facilities in place before expansion of volumes; Shortage of experienced labour at peak times; Lack of flexibility in hours-regular Saturday operations, or 24 hours operations at least 5 days/week."
JF Hillebrand

Agents/Suppliers

"The key issue with receiving problems has been not having an efficient warehouse!"

"Not being proactive with the growth that has occurred over the past five years."

"Too much volume into a single DC with insufficient pull through to make space available."

"Lack of competition and/or alternatives in receiving, warehousing and shipping of product in Alberta."

"The inability of CLS to dealing with increased volumes."

"Lack of planning from CLS management to forecasts for 2006"

Warehouser – Connect Logistics

"The backlogs in receiving at the CLS warehouse have been the result of:

- *Weekly inbound and outbound demand exceeding the overall capacity of facilities in terms of both processing capability and storage capacity.*
- *There is a limited amount of vacant warehouse space in the marketplace making a quick resolution to space shortages difficult.*
- *The limitation of the current warehouse management system requires that all outbound production be processed through the Connect 1 facility, adding to the challenges of facility congestion and production limitations.*
- *Labour shortages in 2006 have impacted the number of employees showing for work and available to hire*
- *The timing of inbound product arriving at the facility either at the incorrect time or in quantities that exceed the capacity of the operation.*
- *The increased complexity of inbound loads in terms of the number of products per container has increased unloading time."*

Downstream Associations

"A warehouse that was built to handle approximately 800,000 cases of inventory attempting to handle in excess of 2,000,000 cases."
Alberta Liquor Store Association

Independent Licensees

"Clearly, unscheduled deliveries to Connect"

PwC Comments

The existing "appointment" arrangement with a separate building lease on the St. Albert warehouse does not provide a framework for longer term investments by CLS. CLSs appointment can be terminated at relatively short notice. Alternatively additional providers can be "appointed" affecting CLS's commercial position.

CLS acts as a service provider and has no commercial or other strength to require the cooperation of the other supply chain participants to provide the information needed for proper throughput planning. In addition CLS has no mandate to manage the flow of goods when deliveries in particular exceed the reasonable capacity of the facility.

- There are no objective measures of the efficiency of the warehouse available against which CLS can be fairly measured.

13. ***Given that the backlog in receiving is not acceptable, what improvements would you suggest making in the receiving process? How would you envision such a system working?***

Specific comments included:

Upstream Associations

"Any authorized service provider should provide in a transparent manner its inbound requirements and business practices and policies so that other market participants can co-ordinate their own activities to align each parties' business activities."
Spirits Canada

"A second warehouser/distributor would be our first choice"
ContainerWorld

- *Create inbound buffer storage-for containers and products.*
- *Improve demand planning*
- *Create central inbound control.*
- *Prevent unscheduled inbound shipments.*
- *Key issue is limited constrained capacity and no control over Inbound shipments"*

JF Hillebrand

Agents/Suppliers

"I would suggest that the freight forwarder up date CLS on a daily bases as to the movement of all purchase orders they are managing once the product is on route to the St. Albert warehouse."

"Look at incentifying both the retailer to take orders earlier and the agent to spread out the orders over a longer period to help take off some of the pressure.

"The market should be advising expected volumes in advance of the period to allow the DC to plan staff effectively."

"…have one warehouse that is efficient"

"…permit suppliers to ship directly to retailers who order a trailer load of products."

"Two warehouses. Split the province, one warehouse in Calgary, another in Edmonton and not Connect."

Warehouser – Connect Logistics

1. *Implementation of a new Warehouse Management System*
2. *Increasing space availability*
3. *Increased throughput capacity*

Independent Licensees

"…the only path I see for improvement is a second warehouse in Calgary"

PwC Comments

CLS is working on a structured improvement plan to improve the flexibility of its operations based on the investment program described above. These plans need to be fully quantified and used as the basis for proactive performance management by the AGLC.

All the suppliers, agents and retailers working in the system should be required to provide the AGLC with detailed forecasts of their 2007 volumes. These should be used for planning purposes and to monitor their performance as well to aid decision making in the event of supply exceeding capacity at critical times. The AGLC should reserve the right to be the final decision maker in the event of the industry and CLS being unable to manage within the capacity of the system.

6.4.3.3 Warehousing

14. To what extent are the issues surrounding difficulties at the CLS warehouse stemming from challenges related to peak times of the year? How can sufficient flexibility be built into the system so that the supply chain functions efficiently, effectively and economically in peak periods and in low periods?

Specific comments included:

Upstream Associations

"The ability to deal with peak volumes is clearly a key component in determining the capacity requirements of each component in any interconnected system."
Spirits Canada

"Improved communication between the agents, freight-forwarders and the warehouse should enable the warehousing/distributing company to handle the increased volumes and continue to effectively serve its customers."
Beverage Alcohol Importers Council of Alberta

"There is no question that many of these problems stem from challenges related to peak times of the year. The industry can and does accept that there will be difficulties, delays etc as a result of high volumes. However, many of these issues can be minimized with good planning and good communication with the trade."
ContainerWorld

"Warehouse and logistical structure are based on demand, volume, assortment and market characteristics of 1994. perhaps it is appropriate to completely reassess the situation and update calculations for the future."
JF Hillebrand

Agents/Suppliers

"Some of the problems that have occurred were created due to unplanned peak periods. This should have been collaboratively planned."

"Look at other warehouse operators and what solutions do they offer. Incentify an industry to order early at the same time as incentify retailers to take it early."

"…the current warehousing/distribution challenges are mostly due to CLS's gigantism, its lack of flexibility, its centralization policy, and its location."

"We see the solution as being another warehouse option or another distribution option for agents and suppliers"

Warehouser – Connect Logistics

"The CLS warehouse solution needs to be designed to deliver the peak season requirements. it is critical that the right business rules are in place with the manufacturers and retailers to ensure that the distribution infrastructure is not unnecessarily stressed during the peak season period.
CLS can provide varying levels of flexibility. Each level in flexibility has a corresponding increase in cost. It important to decide what level of flexibility is appropriate for the industry to achieve the desire balance of flexibility and cost."

Downstream Associations

"ALSA believes that four overarching elements are the root cause of the disastrous 2006 warehouse mess.

- *Structural – A warehouse originally designed to handle 800,000 cases attempting to service 2,000,000 cases.*
- *Regulatory – Notwithstanding that the GLA and GLR confirm that the AGLC have a fundamental role in the supply chain management, gaps exist and require prompt attention.*
- *Coordination – The past seven months clearly confirmed that reliable and accurate information was absent. Fundamentally, all sectors demonstrated that accurate and reliable supply chain information is critical to ensure that facts as opposed to faults would be the key focus.*
- *Communication – Critical to success is open dialogue between the sectors that is reliable and timely."*

Alberta Liquor Store Association

"…the AGLC and CLS must do a better job forecasting demand and planning for spikes in volume. In the absense of competition there must be performance incentives in CLS' contract to ensure service levels are maintained and delivery times are guaranteed during busy peak times. Strategies must be implemented to add additional staff and operate the warehouse 24/7 during these times without downloading these additional cost on to licensees.

Canadian Restaurant and Food Services Association

Independent Licensees

"The major issue that I can see here is one of cash flow from the retail side. Since there is no credit in this industry, then there will always be massive spikes as retailers prepare for higher volume periods"

"…the answer to this is very good forecasting."

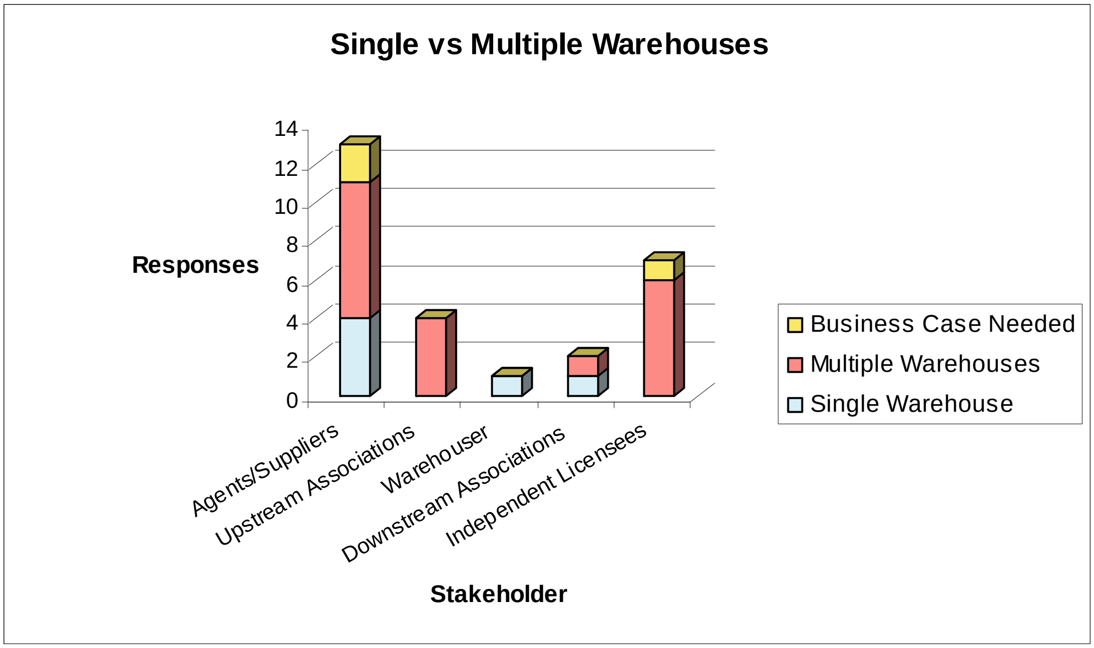
PwC Comments

CLS is working on a structured improvement plan to improve the flexibility of its operations based on the investment program described in its reply to Question 13. These plans need to be fully quantified and used as the basis for proactive performance management by the AGLC.

All the suppliers, agents and retailers working in the system should be required to provide the AGLC with detailed forecasts of their 2007 volumes. These should be used for planning purposes and to monitor their performance as well to aid decision making in the event of supply exceeding capacity at critical times. The AGLC should reserve the right to be the final decision maker in the event of the industry and CLS being unable to manage within the capacity of the system.

15. Some stakeholders have suggested that having more than one warehouse in the province would improve the effectiveness and efficiency of the liquor warehousing and distribution system. Do you believe that having an additional warehouse in the province would improve the current situation? If so, how?

Of the 27 respondents that answered this question, 18 believe that having an additional warehouse would improve the liquor warehousing and distribution system.



Specific comments included:

Upstream Associations

"The limit of one authorized warehouse provider in the province (for products other than domestic beer) meant that when difficulties were encountered there was very little flexibility in the system to provide relief or even a safety valve. As for all monopoly situations, when the sole service provider cannot provide the requisite services, the whole system crashes with devastating results for those affected"
Spirits Canada

"Having multiple warehouses or storage facilities did not solve the problem but possibly added to it, causing even more delays in assembling orders"
Beverage Alcohol Importers Council of Alberta

"Multiple warehouses could work if products were separated by products with different characteristics."
JF Hillebrand

Agents/Suppliers

"I feel that one warehouse for the shipping of product through out Alberta and the rest of Canada can be very effective if it focuses on the job it is hired to perform."

"We require one efficient warehouse! Two warehouses would not be beneficial, all that is required is one warehouse built to warehouse all the products in one place."

"…it is time for a Calgary liquor warehouse to service Southern Alberta. Not only will this take the load off of Connect, it will improve service levels to all of Alberta."

"The introduction of a second warehouse may assist with improving the effectiveness and efficiency of liquor warehousing and distribution, but there should be a critical evaluation before proceeding."

"An extra warehouse is not necessarily the solution. It should be analyzed and assessed for extra cost versus benefit"

"A second warehouse should be considered but with 1 common order line and 1 payment to help the retailer."

"I do not think that an additional warehouse from the same company would help"

"A city such as Calgary should have its own warehousing/distribution channels, since Calgary is the final destination of at least 65% of the product arriving in the Province."

"I strongly believe that a Calgary location in addition to Edmonton would address many of the issues referred to in this paper."

"An additional warehouse owned and operated by a competitor should improve the situation"

Warehouser – Connect Logistics

"…we believe that an additional warehouse in a separate market like Calgary only makes sense if the required distribution space cannot be secured in Edmonton."

Downstream Associations

"…we strongly support the continuation of the single warehouse/distributor model for import beer, wine and spirits as this is the only structure that allows all our members a level playing field in accessing product."
Alberta Liquor Store Association

"The AGLC should give consideration to segregating slow and fast moving skus with dedicated buildings for each."
Canadian Council of Grocery Distributors

Independent Licensees

"Yes, having another warehouse in the province would improve the current situation."

"I believe that additional warehouse space would only be useful if it separated products rather than duplicating them."

"The possibility of a second warehouse in Alberta to supply retailers is something that should be thoroughly researched. All of the pros and cons should be considered."

PwC Comments

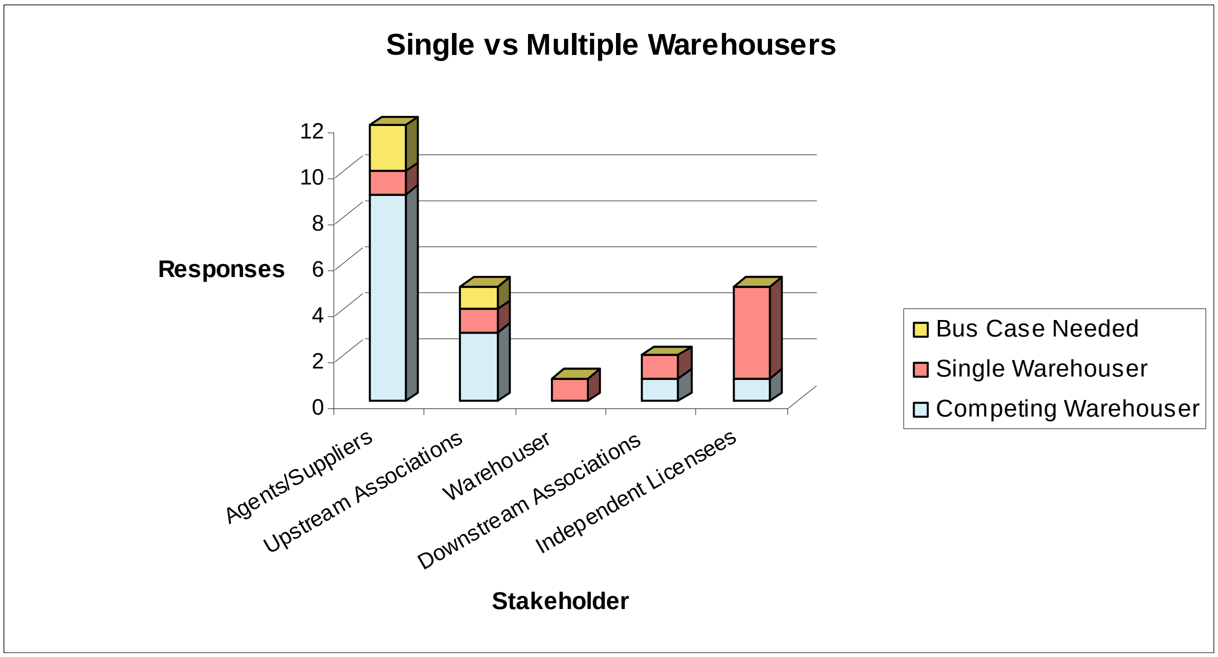
Arriving at a long term solution to this question will be driven by a determination of how the supply chain will be coordinated. The coordinator(s) will quickly see their best way forward to minimize costs and maximize service.

The introduction of a second warehouser in the short term would likely be a significant distraction to efforts to ensure a smooth operation, at least in 2007. Before introducing a second player there will need to be:

- A definition of the role of that warehouse, it's responsibilities within the existing system;
- An assessment of the IT system impacts on the AGLC including linkages to the provider;
- Agreement of the order processing arrangements to ensure equity at retail; and
- An assessment of the possible impacts on CLS.

16. If you have the view that another warehouse operation is needed in the province, would you envision this as an additional CLS warehouse, or a warehouse operated by a competing firm? Would you envision this warehouse as a full warehousing and distribution centre (like the St. Albert warehouse), or as a liquor storage facility only?

Of the 25 respondents that answered this question, 14 believe that a competing warehouser would be an appropriate solution, 8 believe that a single warehouser is the optimal solution and 3 believe that a formal business case needs to be done to analyze the costs and benefits of each.



Specific comments included:

Upstream Associations

"Some of our membership supports having a competitive environment for the warehousing and distributing component of the supply chain. Having said that, additional warehouse facilities in Alberta whether operated by CLS or a competing company, could possibly add to the logistics problems; having to split inventory, manage inventory in both locations, in-bound shipments would have to split at the dock and shipped to each warehouse… All of these factors add to the overall costs…"
Beverage Alcohol Importers Council of Alberta

"A warehouse operated by a competing firm, to give the full competitive benefits of free enterprise".
ContainerWorld

Agents/Suppliers

"Allowing suppliers &/or agents to receive and warehouse their products in their own bonded warehouse."

"We require one efficient warehouse! Having two warehouses increases costs, splitting inventory, especially on small niche products increases labour and costs to move inventory from one warehouse to the next. Having two warehouses will directly hurt small Alberta importers. Overall two warehouses is a logistics nightmare,"

"A true private system should have competition in the warehousing system. Let Connect handle Northern Alberta, and another company handle Southern Alberta. (Full warehousing and distribution centre)."

"The basic tenants that applied to the central warehouse model at the time of privatization should be considered again when trying to determine whether the second warehouse should be a CLS facility or that of a competitor. The decision should favour the outcome that best manages cost to suppliers and retailers while preserving the controls and accountability expected by the AGLC."

"It does not make sense to have another AGLC sponsored monopoly operation with a different warehouse provider."

"I do not think that an additional warehouse from the same company would help. On the contrary, it might generate more problems and costs since an Agency would have to keep stocks in two different places. Two or three warehouses from different companies would solve the problem"

"My preference would be a group of non-CLS warehouses, since I prefer free competition to monopoly."

Warehouser – Connect Logistics

"The implementation of another warehouse operation in the province, whether full-line or liquor only, will result in duplicate inventory, duplicate infrastructure, lower volume, and increased uncertainty. This will materially increase the cost of liquor distribution and negatively impact the Alberta distribution model."

Downstream Associations

"We do not support the establishment of multiple warehouses."
Alberta Liquor Store Association

Independent Licensees

"I would recommend one warehouse for the North and one for the South, and both being CLS warehouses."

"Either Connect or another firm would be fine with me, provided there was no duplication of products. One Warehouse, one product."

"I do not see the need to have the southern Alberta warehouse in competition to the St. Albert warehouse."

PwC Comments

The decision on the number and location of warehouses should result from the medium to long term decision as to which supply chain control model is adopted, namely "Supplier Push", AGLC control or "Retail Pull". Each model will lead to the Supply Chain evolving in different ways with different optimal solutions. A further consideration is the cost and complexity of linking multiple warehousers to the AGLC's systems to ensure that the AGLC is able to discharge its first receiver function reliably and effectively.

The model chosen will impact on the requirements (if any) placed on operator(s) by the AGLC under a multiple warehouse scenario. For example, decisions will be required on whether every warehouse serves every retailer with every product with "Postage Stamp" pricing or if there will be a less control oriented approach with the potential impact that there will be pricing differentials to retailers based on products, location, purchasing power etc.

17. An additional warehouse operation would have costs associated with it, such as additional costs to agents and suppliers to have increased inventory, additional overhead to run two warehouses instead of one, and additional costs (e.g. trucking and handling) to deliver smaller loads. Do you think these additional costs would outweigh the potential benefits of another warehouse?

Specific comments included:

Upstream Associations

"We would suggest that each warehouser would be required to distribute to the entire province. Further, we would see the Agents making their warehouser decision by placing all of one suppliers SKU's into only one warehouse"
ContainerWorld

"A comparison of the costs of out of stock, demurrage, waiting time would be required to evaluate alternative warehouses."
JF Hillebrand

Agents/Suppliers

"The cost should not be higher as traditionally competition lowers cost not raises them. Have the agents pick one warehouse only or better have them split by domestic and import."

"It would be imprudent to view the possibility of a second warehouse as a short term decision. Instead, the AGLC and CLS have to decide whether the current conditions will persist and if additional capacity can be justified for the long term. Thereafter, it becomes a capital budgeting decision where potential costs and benefits are considered quantitatively and qualitatively."

"The cost should not be higher as traditionally competition lowers cost not raises them. Have the agents pick one warehouse only or better have them split by domestic and import."

Warehouser – Connect Logistics

"The bottom line is that the additional costs are not necessary to succeed. Again, an additional warehouse adds costs, reduces service and does not address the core liquor supply chain issues."

Downstream Associations

"We do not support the establishment of multiple warehouses."
Alberta Liquor Store Association

Independent Licensees

"I believe the extra cost DO NOT outweigh the potential benefits of another warehouse because their SALES will go up, there should be very little extra inventory because you would be able to delete all the Storage warehouses currently being use. As for the additional overhead, some saving could be realized by not needing the storage warehouses, increased sales, reduced overtime by not having to handle product 2 and 3 times."

"If the warehouses did not duplicate product, then the costs would be much less. Since the extra capacity is required, I do not believe the additional costs would be much different than a normal expansion."

"Having two warehouses, one that supplies Northern Alberta and one that supplies Southern Alberta would alleviate pressures at the one current existing warehouse and give the consumers more flexibility if on of the warehouses were to fall below current service standards."

"I would expect that the warehouse needs of the St. Albert location would decrease significantly whereby costs would decrease. Initial cost to a southern Alberta location would be huge. I would envision the operations be separate but the costs amalgamated or considered as one entity."

PwC Comments

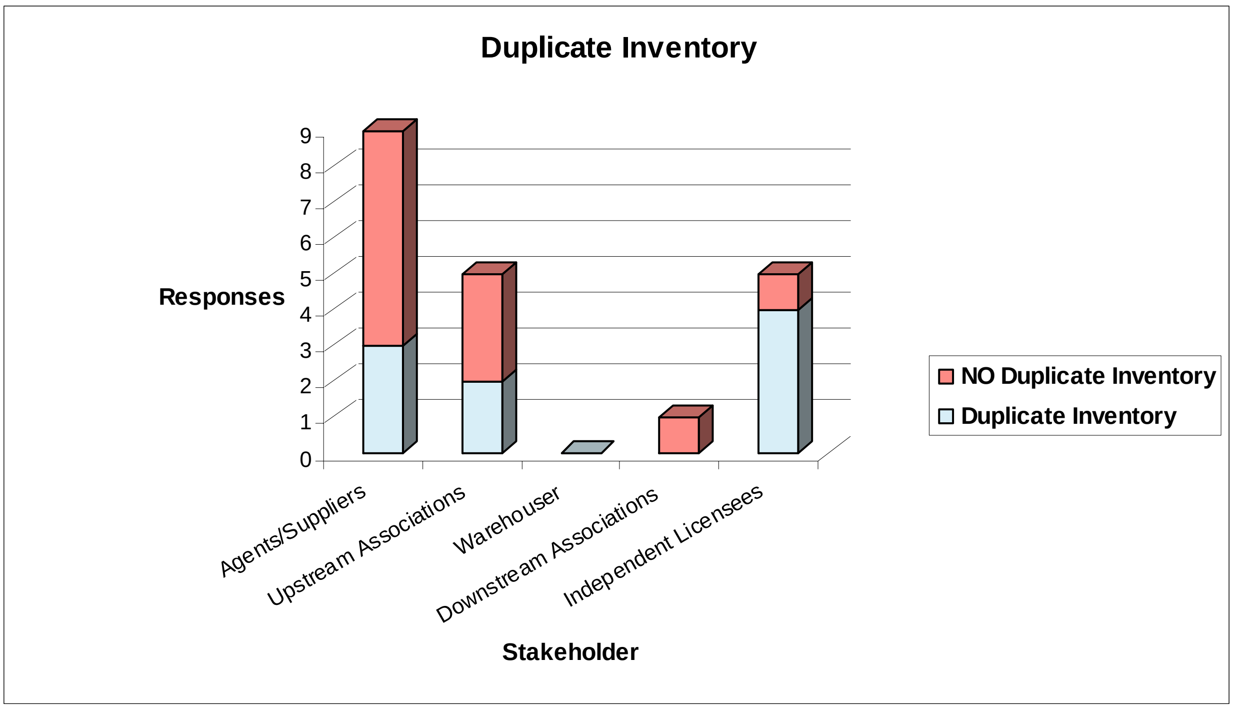
The decision on the number and location of warehouses should result from the medium to long term decision as to which supply chain control model is adopted, namely

"Supplier Push", AGLC control or "Retail Pull". Each model will lead to the Supply Chain evolving in different ways with different optimal solutions.

It would generally not be good practice to assume that both warehouses would simply offer the same SKUs and services. Good practice would allow the flexibility for multiple players (if appropriate) to develop specialist offerings. For example one warehouse might wish to focus on slow moving specialty items and the other on fast moving SKUs. Many other permutations are possible.

18. How would you envision such a warehouse working? For example, if there were a warehouse in the north and in the south, how would you ensure that all licensees would have all products available to them regardless of their location in the province? Would agents/suppliers be required to carry sufficient inventory in each warehouse? Would there be different LTO periods in different parts of the province? Would the same postage stamp rate continue to apply to deliveries to licensees? How would equal treatment of licensees throughout the province be ensured? Is equal treatment an important principle?

Of the 20 respondents that answered this question, 9 believe that inventory would need to be duplicated in each warehouse. 4 of 13 believe that different delivery rates should apply. Zero of 7 believe that different LTO periods would apply.



Specific comments included:

Upstream Associations

"Every licensee would be able to order from each and every warehouse. Warehouses would deliver a minimum 25 cases or a minimum of 1 case, setting their delivery prices accordingly, no more postage stamp delivery rates, although wholesale pricing ad LTOs would still be the same for all and price changes would be effective simultaneously.

Wholesale agents could stock their products in one or multiple warehouse locations within the province. Warehouses could offer variable service, specializing in volume products or items with more restricted availability and charge accordingly. Competition has a way of encouraging the best value and service."
Beverage Alcohol Importers Council of Alberta

Agents/Suppliers

"All of our inventory management is based on demand. If there is demand in the North or the South, we would make sure product is available or we lose sales. We would deliver product to St. Albert and to Calgary. If a supplier does not want to carry "sufficient inventory" that is there decision. They lose the sales. No different than Connect not being able to accept deliveries, therefore causing out of stocks. No different LTO periods. This would become a logistical mess for the AGLC, retailers and for suppliers. Same postage stamp rate."

If a two warehouse scenario existed in a North/South orientation, (we) do not think licensees' access to products would be compromised, particularly if certain liquor products are assigned to a warehouse. Effectively, all product is still available through CLS. Only the service frequency might have to be adjusted for the source. Given the nature of product movement, there would likely be backhaul opportunities between Calgary and Edmonton resulting in some internal economics and cost savings. It may also be worthwhile for CLS to secure a number of power units, trailers and drivers and achieve a rolling warehouse, as well as have labour and equipment on standby for movements when other carriers are not available. I would not necessarily promote agents and suppliers placing inventory in two locations unless the service model can secure economics in shipping from a closer location. For slow moving or low inventoried product, this would further fragment the holdings and aggravate the problems."

"It can be anywhere as long as delivery is efficient / cost effective. Equal treatment is not important in our opinion."

Downstream Associations

"We do not support the establishment of multiple warehouses."
Alberta Liquor Store Association

Independent Licensees

"Agents/suppliers would be required to carry sufficient inventory in both warehouses. There shouldn't be problem with the same or different LTO's as each warehouse would be serving a different part of the Province. Should be able to keep the same postage stamp rate through out the Province"

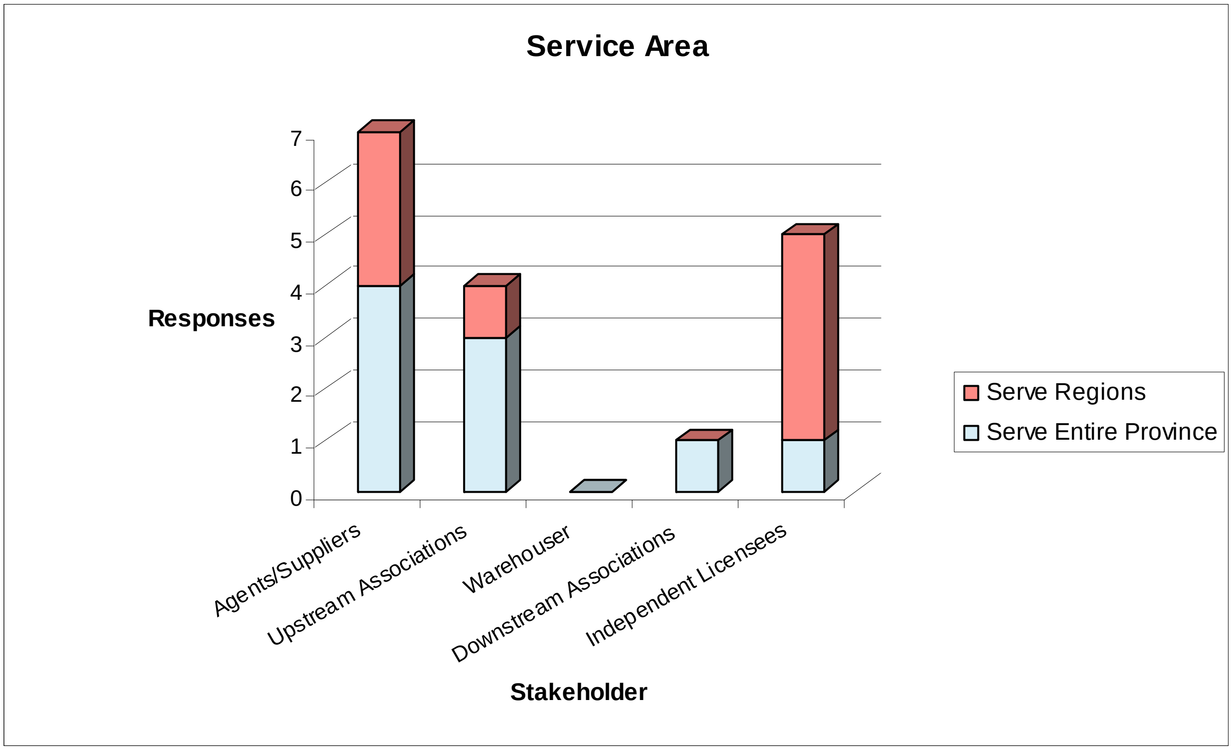
"I would not duplicate products, but rather separate categories. If all wine came through Edmonton and all beer through Calgary for example, then each city would get fairly equal service, as opposed to the advantage Edmonton currently has. This system should allow the current system of "equality" to continue."

PwC Comments

It would generally not be good practice to assume that both warehouses would simply offer the same SKUs and services. Good practice would allow the flexibility for multiple players (if appropriate) to develop specialist offerings. For example one warehouse might wish to focus on slow moving specialty items and the other on fast moving SKUs. Many other permutations are possible.

19. If there were one warehouse in the north and one in the south, how would you see this creating "free-market competition" between warehouses? Would each warehouse need to serve the entire province to ensure that licensees have choice? What effect would that have on agents' inventory (see above)? Would agents have to stock all products in both warehouses?

Of the 17 respondents that answered this question, 9 believe that each warehouser would serve the entire province.



Specific comments included:

Upstream Associations

"There would be no economic benefit from taking the current monopoly for the province of Alberta and splitting it into two smaller monopolies (e.g. north and south). Economic benefits would only flow if authorized service providers were allowed (and encouraged) to compete for business. Under a competition model, there would be no increase in overall agents' inventory levels in the province as an agent would likely only contract with a single service provider."
Spirits Canada

"If this is the case then agents will have to inventory product in the facility, if you want to retail that product in the south. And if that warehouse had to deliver to the whole province then agents could (decide) what warehouse to use based on service and fees…"
Beverage Alcohol Importers Council of Alberta

Agents/Suppliers

"Multiple warehouses could be a solution, but only if distribution takes place from one warehouse. Multiple distribution warehouses would only mean that suppliers would have to replicate stock in multiple locations. This could exacerbate the "slow moving products" issue.

"If there were two agencies, Connect in the North , and a new company in the South, you would still see competition. I guess the confusion will be that technically, it is still not a free market competition because you have one choice in the north and one in the south. That said, maybe there should be consideration given to having two in the north and two in the south."

"…if different companies were competing for liquor supplier or agent business on the basis of cost and services then free market competition is more likely to be achieved."

Warehouser – Connect Logistics

"CLS does not believe that an additional warehouse will improve service and it will result in an increase in cost to the manufacturers and retailers, and ultimately the end consumer."

Downstream Associations

"We do not support the establishment of multiple warehouses."
Alberta Liquor Store Association

Independent Licensees

Free-market competition would benefit the large retailers and hurt the small ones as the warehouses would compete for the large retailers with the small ones left in the dust.

I think duplicating products will create 2 nightmares. One in which product is available at the warehouse where it isn't needed, and the second being that small agencies will not have the financial ability to support the extra product and effort required to maintain it. Separate product warehouses will still require agents to visit more than one warehouse, but I would think this is a small matter compared to the problems of scheduling 2 inventory levels.

PwC Comments

It would generally not be good practice to assume that both warehouses would simply offer the same SKUs and services. Good practice would allow the flexibility for multiple players (if appropriate) to develop specialist offerings. For example one warehouse might wish to focus on slow moving specialty items and the other on fast moving SKUs. Many other permutations are possible.

6.4.3.4 Delivery to Retailers

20. Are there processes related to the ordering of liquor products that could be improved? Which ones? How could this best be achieved?

This question was really only relevant to the downstream stakeholders.

Specific comments included:

Warehouser – Connect Logistics

"Overall order cycle times and short ships could be improved by placing different shipment windows for slow moving product. Within the warehouse environment, the slow moving product is the least productive to assembly and the most time consuming. By allowing the aggregate volume of slow moving product to build, fast moving product can be dispatched from the warehouse much quicker."

Downstream Associations

"…a close examination of the ordering system is critical. In particular an examination of the issues of "short shipped" and "stock outs".
Alberta Liquor Store Association

"First and foremost is better customer service and improved communications." The order desk must do a better job communicating with retailers/licensees with respect to their order status and delivery times. When short shipments and stock outs occur, the order desk should constantly be communicating and working with retailers/licensees on flexible solutions such as allowing substitutions without having to reorder a full 25 case minumum until the problem is solved.
Canadian Restaurant and Food Services Association

Independent Licensees

"…the out of stocks and the short ships do have a huge impact on the small retailers as we only have one chance to order it in, in any week."

"Overall order cycle times and short ships could be improved by placing different shipment windows for slow moving product."

"…the order taking system should permit licensees to place orders 24/7"

"Ordering on non-scheduled days should be penalized through surcharges."

"I would suggest a pre-authorization process. Meaning a retailer can start their order in advance. Connect would be able to see this pre-order and remove these products from their inventory. They would consider them as sold at that time. This would allow outlets to have products on hold for their order."

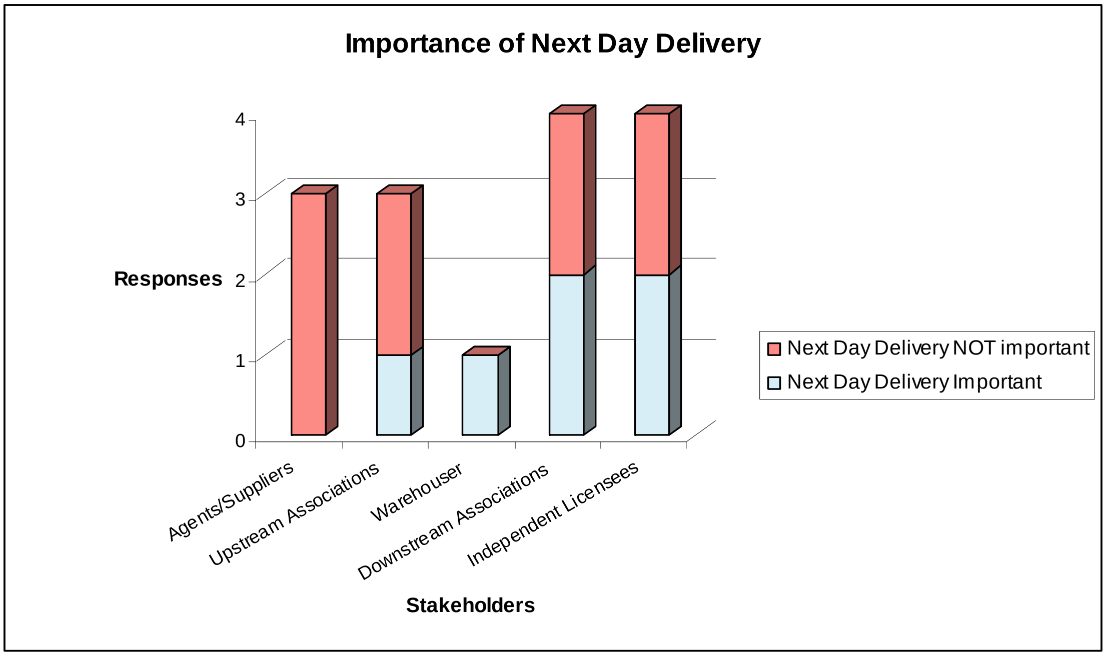
PwC Comments

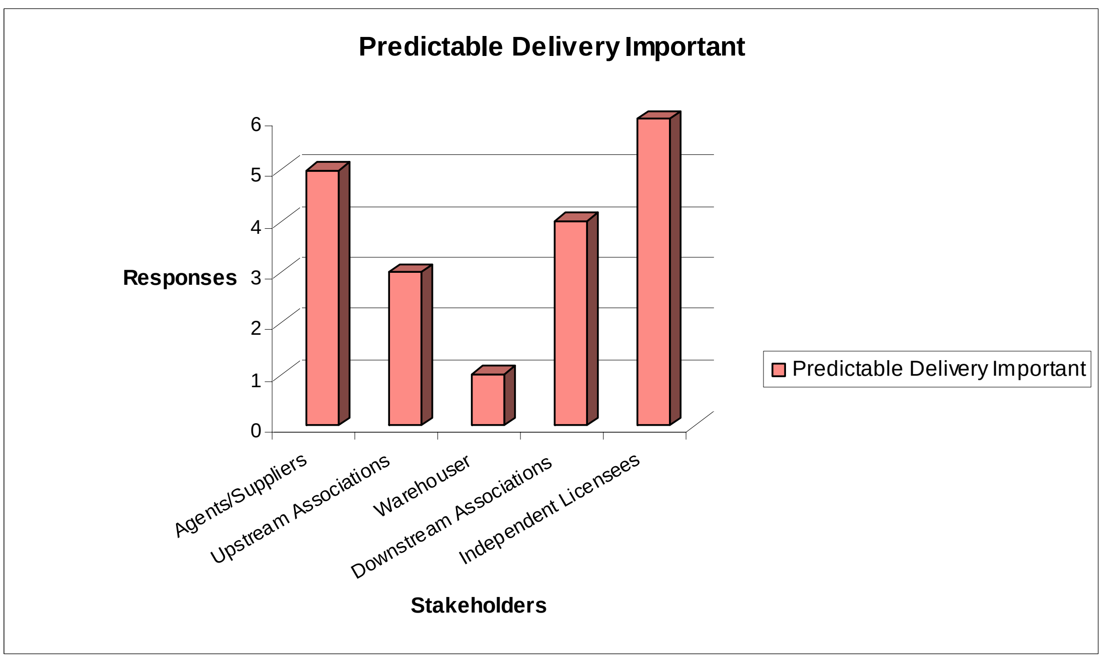
The current processes are suitable in principle for the current system. Any changes such as two warehouses may lead to issues such as the need for a separate order and allocation system between multiple vendors.

The absence of defined service requirements with supporting monitoring and remediation systems is a weakness of the current arrangements

21. To what extent is next day delivery a realistic expectation in today's labour market? What is a realistic order-to-delivery period? Is the delivery period the key issue or is it the certainty of the delivery date?

Of the 15 respondents that answered this question, 6 believe that next day delivery is both realistic and a key issue. All stated that predictable delivery was the key issue.





Specific comments included:

Upstream Associations

"Certainly of delivery is the key service parameter."
Spirits Canada

"Next day delivery is definitely still a cost effective realty, especially within the major cities, even for some of the larger rural communities."
ContainerWorld

"Consistent delivery is the most important. Whether it is 24 or 48 hours is not an issue if schedules are met."
JF Hillebrand

Agents/Suppliers

"…in general I feel that next day delivery is not realistic at all. I would think somewhere between 4 to 6 day delivery would work great."

"Both the delivery period and the certainty of a delivery date are important, however emphasis must be placed on certainty."

"Next day delivery is certainly a luxury that I believe can be moved back to accommodate some of the issues currently with Connect."

"Next day delivery, especially during peak season, may not be possible given Alberta's current labour market conditions and CLS facilities. Although it may have been achieved in the past, one day service may be more of an aspirational goal for the future, but ultimately, expectations may have to be managed."

Warehouser – Connect Logistics

"Next day delivery is a reasonable expectation and not tied to the labour market. The priority now is to deliver with consistency and predictability."

Downstream Associations

"Fundamentally, the key requirement is consistent and predictable delivery that is cost efficient."
Alberta Liquor Store Association

"Next day delivery is a realistic expectation in today's labour market, especially for high volume products, if the right strategies are implemented. However, what is most important to licensees is not the delivery time period but the certainty that the deliveries arrive on the date promised."
Canadian Restaurant and Food Services Association

"As stakeholders, our main concern is the "just in time" delivery of liquor to our members in a manner that is predictable, sustainable, and consistent. Necessary revisions to the delivery schedule must be determined, and that timeframe adhered to as the new standard."
Alberta Hotel and Lodging Association

Independent Licensees

"There is no reason not to be able to get back to 24 to 48 hour deliveries.

“A three to four day delivery period seems to be an acceptable amount of time to receive an order after its been paid for.”

“Certainty of delivery date is of more importance”

“Next Day was nice, but 2 day is fine. The certainty of the delivery date AND time of delivery is more important than the speed at which it ships”

PwC Comments

Next day delivery should be possible providing that competitive wages and other remuneration elements are in place. This level of service is not an option in many other businesses. The provision of next day service is often a function of the volume and mix of the orders to be delivered as well as the location of the customer. Where a next day promise is made it is often for high volume products ordered in bulk for delivery to major centres. Slow moving items are often delivered less frequently to allow for load consolidation. Delivery outside major centres is also typically less frequent than in major centres unless the volumes warrant more frequent delivery.

7 Conclusions

These conclusions are not supported by quantitative analysis of the existing operations. Quantitative analysis is outside the scope of this review.

The Alberta model, which has been in place for approximately 15 years, has been very successful in meeting its original policy goals.

- Consumers have access to a much wider selection of products;
- Effective control over the sale of liquor products has been maintained;
- Liquor prices have remained relatively stable;
- New retail liquor stores have been established including some in communities not previously served;
- New jobs have been created throughout the province; and
- The revenues generated by the Government of Alberta have not been negatively impacted by privatization.

In the last 15 years the economy of Alberta has developed significantly, particularly in the last few years. In addition the players in the industry have become increasingly adept at using the model and the processes that support it, sometimes in ways outside of what was originally planned. For example the LTO system has, as was stated during this review, evolved in part into a method for suppliers to offer "bulk" discounts to large volume buyers. This is not consistent with the objective of a single price at wholesale for all retailers; it is however consistent with the reality of private markets. Given this example we conclude that the time is right for a wide ranging study of the Alberta Liquor Distribution model to recognize the learnings of the last 15 years.

A further key point is that the St. Albert facility was significantly under used in the early years. This "over capacity" allowed suppliers/agents and retailers to operate with almost complete flexibility. Over the years many tactical improvements have been made at St. Albert which have allowed it to continue to serve the market without there being a need to consider the long term issues which were developing as the Alberta economy expanded rapidly. The sudden boost in demand experienced in the last two years has suddenly bought all these issues into sharp relief:

- The finite capacity of the facilities at St Albert;
- The lack of structured product flow management based on capacity planning and scheduling from production to sale;
- The lack of a key decision maker in the event of conflict;
- The lack of a capable single entity with long term planning responsibility (with the requisite skills and tools);
- The lack of normal commercial disciplines on the introduction of complexity in the form of slow moving or low volume SKUs;
- The lack of formal performance measures for all the supply chain players including CLS;
- The lack of a framework for making long term capital investments as needed in the system; and

- The lack of a "rate" schedule which reflects the actual activities and efforts in the CLS operation (leading to cross subsidization and lack of incentive to act "commercially").

In addition to the points noted above, other issues continue to be of concern to both suppliers and retailers:

- The LTO system is perceived as "unfair" by small retailers and as a complex way of "rewarding" large volume buying customers by the suppliers and their customers. This latter view exists despite the express policy of the AGLC (as defined in the principles of privatization and stated in Section 80(2) of the Gaming and Liquor Act) that all retailers should be able to buy all products at wholesale at the same price;
- The request by the domestic brewing industry that they be allowed to handle the import beers that they represent through their existing distribution system rather than through CLS.

Comments and Conclusions

Based on observation and the qualitative information supplied, the current operation is likely not sustainable without a significant increase in capacity or the introduction of better use of the existing capacity based on data sharing up and down the supply chain with a defined mechanism for resolving conflicts at peak periods.

While the existing system does generally define the responsibilities of each of the players clearly, that does not mean that the individual roles lead to an efficient whole. In particular CLS is expected to handle any shipment sent to it and to be able to dispatch on schedule any volume ordered. CLS is expected to do this while operating effectively on a short notice period and with no defined mechanism to support longer term investments other than a very basic tariff schedule. A further issue is that CLS's appointment terms do not include any formal service standard requirements though a clear expectation has built up over the approximately 15 years that CLS has served the industry.

The situation is further complicated by the current schedule of charges which is simplistic and which does not in particular recognize the reality that low volume SKUs are more costly to handle than high volume SKUs, just as slow moving SKUs are more resource consuming than fast moving SKUs. The result (as acknowledged during this review) is that the fast moving SKUs are in some measure cross subsidizing the slow moving/low volume SKUs. The extent of this cross subsidization will only be clear with a quantitative analysis. This practice means that there is not the full commercial pressure on agents to make a case for the introduction of multiple SKUs, indeed given the relatively low storage rates compared to other provinces there is less than the normal incentive to move slow selling stock. This conclusion is not meant to suggest that there should be any limitation on the number of SKUs that an agent can offer, rather that the full costs should be reflected in the warehouse charges. That in turn will likely mean the development of a more comprehensive tariff schedule by CLS.

Before looking forward to meeting the challenges of 2007 and onwards it should be noted that the existing system makes it difficult to define who is responsible for service failures. As was clear during the review each segment of the industry sought to "point fingers" at the others without recognizing the limitations each player was working under. While there were many constructive suggestions they were generally made without putting the suggestions into the working context of the other players in the supply chain.

The existing system does not require the players in the supply chain to cooperate in any meaningful sense. Numerous players expressed a willingness to share data but the terms of such cooperation were not defined, the tools to be used were also not agreed on and critically, the responsibility for decision making when conflicts arose was not defined. In short, many good intentions were expressed in the absence of any framework for making substantial progress. Experience has shown that these good intentions often do not get translated into action when the details are defined, especially if the result may lead to a reduction of control and flexibility at peak periods for some of the players.

We must therefore conclude that little action will happen in terms of data sharing and cooperative planning and balanced decision making in the current model without the AGLC stepping back in, at least temporarily, to ensure that the necessary framework is put in place and that all the players are required to cooperate if they wish to participate in the Alberta market.

We further do not believe that it will be appropriate to significantly add capacity, whether additional warehouses, vendors or extension of the existing facility without a carefully prepared business case based on a suitably detailed quantitative analysis of the relevant operational and financial data including future volume forecasting based on projected levels of economic activity in Alberta. This analysis will require some time and care. Based on our experience, and recognizing that the study may suggest changes to the existing privatization framework, this study is unlikely to be complete in time for meaningful changes to be implemented in time for the 2007 peak season. Indeed typical lead times for the full implementation of fully integrated third party warehouse operations sharing data as is needed within the Alberta model is one to two years, particularly as the AGLC will likely need to upgrade its systems in any scenario which adds any vendors in addition to CLS. We therefore anticipate that the results of this project will apply during 2009 and in time for the 2009 peak selling period.

We therefore conclude that the greatest likelihood of successfully serving Albertans in 2007 and on into 2008 is for CLS to continue to be the single supplier wholesaler for the AGLC. This arrangement should however be based on a more rigorous contractual arrangement which should be rooted in carefully built operating plans for 2007 and 2008. The operating plans should be constructed by approximately the end of May under the aegis of the AGLC by a working group made up of key supply chain participants including the Suppliers/agents, CLS and retailers. It seems likely that CLS or its parent Exel Logistics will be best placed to provide the supporting analytical tools and experienced analysts. This decision should however rest with the AGLC based on input from the project working group. This project will only succeed if there is full cooperation from all concerned. Achieving this will be primarily the responsibility of the AGLC. We also conclude that in the event of there being conflicts, for example over capacity during certain weeks, that the AGLC must resolve the right of final decision at least in the short term if the industry through the working group reaches impasse. We believe that the industry will seek to resolve its own issues so we do not expect that the AGLC will need to use this reserve power.

Once this project is complete we then believe that it will be appropriate for the AGLC to apply performance measures such as rapidity of turnaround and order completeness to CLS. We further conclude that it will be necessary to apply similar disciplines on the suppliers/agents and to retailers. The performance measures for Suppliers/Agents should be based on the forecasts that they supply for the short term project covering 2007 and 2008. This approach is not meant to apply detailed level controls to the players, rather to establish any significant variations which in turn can be used to determine day to day priorities, seek enhanced cooperation and ultimately provide guidance in the event despite best efforts, of significant unexpected demurrage or damage charges on the supply side or lost sales claims on the retail side.

Regarding LTOs, we conclude that the existing LTO system should not be radically altered at this time. Having said that there should be changes made which do not penalize small retailers who are not permitted to order on the day of the LTO release, but rather have to wait until their nominated order day by which time the LTO is likely "sold out". Logically within the current parameters all retailers should at least have an equal chance to place orders at the time of release. While this is easy to say it has the potential to be difficult to achieve in a "fair" manner. Potential problems include:

- Overloading the order system when every retailer attempts to access the system at the same time;
- The possibility that some retailers may seek to "game" the system by "cornering" the LTO and then seeking to trade it out with others;
- The possibility that the suppliers will be reluctant to offer LTOs under any revised rules; and
- The need to alter the existing systems to allow for ordering of products on LTO "out of sequence".

Given the above, and in particular the commitments given at privatization, we believe that the AGLC should state that it does intend to improve the current system with improved rules and supporting systems. The AGLC should then work with the industry and CLS to design the new system and surrounding rules. We would anticipate that this approach will produce a solution for 2007 and 2008 which may be less than perfect but will be closer to what was originally intended. The "who" question of rebates, volume discounts etc. should in the mean time be studied as part of the longer term study which may lead to structural changes in the "Alberta Model" for liquor distribution.

On the issue of imported beers we anticipate that using the integrated planning approach suggested above that there will be sufficient capacity to enable imported beers to be handled as at present through CLS. Given that the AGLC will be conducting a review of the entire liquor supply chain the moving of import beer would create a precedent which other suppliers would feel should be applied to them. In addition given the reach and existing competitive advantage of the domestic brewers would likely disadvantage the remaining beer importers compared to the large brewers. The existence of the precedent could in turn limit the freedom of the AGLC to define any new "Alberta model" based on the work of the proposed longer term study. This conclusion is predicated on the assumption that CLS is able to prepare and execute a plan for 2007 and 2008 including the beer volumes in question. If that is not possible then the AGLC may need to review this conclusion.

8 Alternatives

This section outlines the short-term and long-term alternatives that are available for the AGLC to consider. The pros and cons of each alternative are described.

Alternative 1 – Seek to tactically improve the existing system

This alternative would involve retaining CLS as the sole warehouser / distributor for liquor in Alberta, but increasing flexibility by adding the ability to ship from multiple locations.

Pros

- Least disruptive.
- Better use of existing assets.

Cons

- Will add little capacity in the face of rapid market growth.
- Will become increasingly complex and inefficient leading to poor service and high, ever growing, costs.

Comments

- May cover off for 2007 and 2008 – better than no action but would likely fail at peak receiving and shipping times without planned flow management.
- Does not address key concerns such as the need for defined performance standards for all players in the supply chain.

Alternative 2a – Recreate the model existing at privatization with significant excess capacity – SINGLE Supplier

This alternative would involve building a significantly larger warehouse that would be run by one appointed service provider.

Pros

- Will enable the existing system to be maintained without meaningful change/disruption. Eliminates the need for choices which may be difficult to implement.

Cons

- Wasteful by definition since the added capacity will only be sufficient for a number of years before the existing issues are repeated.

Alternative 2b – Recreate the model existing at privatization with significant excess capacity – MULTIPLE (i.e. more than 1) Suppliers

This alternative would involve building excess capacity by appointing one or more warehousers to handle liquor warehousing / distribution responsibilities for the province.

Pros

- Will enable the existing system to be maintained without meaningful change/disruption. Eliminates the need for choices which may be difficult to implement.
- May allow the introduction of private capital for building the needed excess capacity.
- Responds to demands for competition / free market concepts at the warehouse level (which exists for suppliers / agents and retailers).

Cons

- Wasteful by definition since the added capacity will need to be sufficient for a number of years before the existing issues are repeated.
- Not clear how the unused capacity will be paid for.
- Will require the development of new rules to determine if for example the new facility is required to deliver to all retailers, all products at the same price as the existing warehouse and if not what variations are permitted and the supporting rationale.
- Higher costs.
- More points of contact for the retailers.

Alternative 3 – Move to a managed supply chain with the AGLC as the final decision maker and long term planner working with private sector industry players for supply and retail

Pros

- Clear role definition resolving the issues of accountability and long term planning.
- Consistent with current practice in other Canadian provinces and U.S. "Control" jurisdictions.

Cons

- Undoes a core principle of privatization. Not consistent with free market approach.
- AGLC will need to redevelop the required skills and capabilities.

Alternative 4 – Move to a Supplier/Agent Led Supply Chain

Subject to the suppliers/agents meeting servicing and pricing requirements specified by the AGLC they would determine how many warehouses they wished to use in Alberta. As well, they would act as the final decision makers in managing the flow of product.

Pros

- Aligns with a privatized model better than the AGLC taking the control role.
- Will likely move any investment requirements completely to the private sector.
- Is consistent with the stated position of the suppliers during the review process.

Cons

- Experience with supplier controlled supply chains is that they generally result in higher consumer prices (suppliers seek to control supply to maximize their profitability) and limitations on the number of SKU's available as the major vendors seek to "crowd out" independents.
- This type of supply chain control is rarely found in consumer products. The closest examples in Canada are Tobacco products, Domestic Beer and Automotive Companies.
- Suppliers are further from the consumer along the supply chain and are insulated from consumer needs as expressed to retailers.
- May add complexity to the AGLC in working with multiple warehouses.

Alternative 5 – Move to a Retailer Led Supply Chain

The same as option 4 except that retailers are the ultimate decision makers in the supply chain subject to controls imposed by the AGLC to ensure an orderly market especially in terms of ensuring that independent retailers are not displaced by chains.

Pros

- This type of supply chain management has been shown to enable the greatest efficiency and consumer responsiveness allied with the lowest prices over the long term. It is used for almost all types of consumer goods. Retailers are closest to the consumers and best placed to make fact and market based decisions at peak periods.
- May enable private sector investments in facilities.

Cons

- Will change one of the tenets of privatization in that retailers will seek to use their purchasing power with suppliers which in turn will make "one price at wholesale" no longer possible in any form. In practice, as was stated during the review, the LTO system is already being used such that "one price at wholesale" is currently not the case.
- AGLC will need to create rules which assist in protecting independent retailers and keep them competitive. Independent retailers will also need to act to help themselves, for example through buying groups.
- May add complexity to the AGLC in working with multiple warehouses.

9 Recommendations

The recommendations made are based on the assumption that fundamental market shifts have occurred that require the development of a new/updated Alberta liquor warehousing and distribution model. This new industry model will require clear allocation of roles, responsibilities and accountabilities of key industry players throughout the supply chain.

These recommendations are tiered into short, medium and long term actions:

Short Term

Short term is defined as beginning March 2007 with the initial analysis completed by the end of May 2007, implementation and monitoring through the balance of 2007; to be repeated in 2008.

- The AGLC must take a more active role in managing elements of the industry – particularly in the supply chain – to ensure that service levels and stakeholder confidence are returned to the industry.
- Retain CLS as the sole warehouser / distributor for the distribution of liquor in the province of Alberta at this time, but with a more rigorous contractual regime. Do not make short term changes such as changing the beer distribution arrangements or introducing new warehousing vendors. Such changes are likely high risk as they will add complexity and set precedents in advance of the development of a longer term strategy.
- Formalize the "service provider" relationship by negotiating and signing a contract with CLS to provide services that includes conditions if performance is / is not met.
- Establish and implement formal performance measures against which CLS performance will be monitored; indicators need to include:
    - On-time delivery;
    - Accuracy of shipment; and
    - Customer service.
- Work with CLS to develop a new, expanded, rate structure to better reflect the relative costs of ordering, handling and storing fast moving items as compared to slow moving items. Implement this new rate structure in the summer of 2007 so that it is aligned with the move to the "mixing centre".
- Require all upstream and downstream stakeholders to provide volume and timing forecasts for 2007 (and 2008) to CLS so that proper forward planning can be performed. Ensure that the plan is quantified and tested.
- Establish "rules of engagement" for the suppliers/agents and retailers based on the forecasts used for planning 2007 and subsequently 2008. These rules will be used to regulate product flows and responsibilities and will include consequences if rules are broken.
- Retain the services of a qualified supply chain specialist to support the AGLC including reviewing the plans and monitoring implementation/operation on, at minimum, a monthly basis.

- In the event that supply and/or demand spikes unreasonably at some point, the AGLC would reserve the short term right to impose limits on supply or ordering during certain periods.
- Short list options for refining the LTO system; for example, remove anomalies such as small retailers being forced to wait until their order day before they can order LTOs. Changes such as this will be complex at a detailed level and will require careful consultation with all the parties involved. This project should be completed, however, by June 2007.
- Subject to any legal considerations, give notice to CLS that as a consequence of the changes described above that the existing "appointment" arrangement will revert to a more typical "services contract" arrangement with an expected term to coincide with a transition period following the expected re-tendering of the contract in approximately two years time. The duration of the transition period would likely be determined during the development of the RFP documents in late 2008.

Medium term

Medium term is defined as beginning in March 2007 with the analysis and policy options ready for discussion/decision by August 2007. Target Implementation beginning in 2008 or 2009 depending on the final policy decisions.

Develop an operational and financial business case that considers four options for the physical network:

1. Recreate an environment where the supply network is sized to be larger than the expected peak volume for a number of years to come (essentially the situation at privatization). This option will be capital intensive and likely wasteful as it will involve the building or leasing of facilities which will be underutilized other than at exceptional activity peaks. As consumption grows this solution will at some point again run out of capacity provoking another "crisis". Another version of this strategy has warehouses (and warehousers) being added. This approach will add to the work of the AGLC, especially in its capacity as "first receiver". Maintaining a uniform service for all products and a uniform price structure for all retailers will increasingly not be feasible. The likely result is that Agents/Suppliers will seek to favour a limited range of retailers and "neglect" the rest.
2. Step back in as the regulator either directly, through a third party or through the warehouse operator and dictate the priorities at peak times to the suppliers and retailers based on projections that the suppliers and retailers would be required to provide for planning purposes. In principle this goes against the "free market" principles that Alberta has espoused since privatization. It requires the AGLC to "re-engage" as a regulator (at least in the last resort) of operations as well as its ongoing fiscal and social responsibility role.

   As structured today the AGLC does not have the skills or the resources to undertake this role other than in what would likely be an arbitrary fashion. The current privatization model is structured to offer a "level playing field" to all retailers which in turn has meant an operating construct which does not allowed a "free" market for services such as warehousing to develop (as it could not have done while ensuring level pricing and delivery to all retailers). In this situation Alberta is now faced with either maintaining the current principles which would in turn mean the AGLC returning to a more interventionist role in "managing" the operations of the service providers similar to a utility model or of changing the privatization model with the core options being described below.

3. Adjust the principles of privatization to enable the suppliers to take control openly of the supply chain and to manage it. This option is one that is rarely seen in the consumer goods market. The state of Iowa evaluated this model for liquor distribution a number of years ago and concluded that it was not in the best interest of the state (see section 4.3). However, it is still an option that needs to be carefully considered.
4. Adjust the principles of privatization to enable the retailers to take control of the supply chain and manage it. This model is the one which has evolved as the most common model for consumer goods globally, particularly in the last 30 to 40 years. The retailers are closest to the consumer. Adoption of this model would however require care to ensure that the interests of all groups are considered.

Selecting amongst these choices will be difficult. Each one will have significant consequences for all the parties involved. The decision making process for this long-term strategic direction will require significantly more in-depth analysis. The review would consider the financial, operating and consumer implications of the options and would lead to recommendations on which approach should be adopted and what operating principles / policies would be needed. In making this review the following key priorities would be followed:

- Compliance with Federal requirements;
- Maintaining social responsibility;
- Ensuring a diversity of products;
- Ensuring service and price competitiveness to all Albertans;
- Supporting employment and enterprise in the retail sector; and
- Securing the revenue flow to the Province of Alberta.

Long term (2009 onwards)

Based on the results of the in-depth review, issue an RFP for one or more warehousers to deliver warehousing and distribution services for a fixed period, for example 5 years. The transition would take place over a time period to be defined during the RFP process. The time required for transition would in part depend on whether there would be a requirement that any successful bidder(s) continue to operate from St Albert or if they would be free to create a new network. Analysis of this question should form a part of the business case analysis described above.

Appendix A – List of Respondents

Agent / Supplier

- Alley Kat Brewing Company
- Andrew Peller Limited
- Beverage International Distributor
- Bottoms Up Beverage Co.
- Cellar Stock Importers
- Chilkoot Brewing Co. Ltd.
- Delancey Direct Inc
- E&J Gallo Winery Canada Ltd.
- Great Western Brewing Company Ltd
- Maxxium Canada
- Medallion Wine
- Metrovino Inc
- Mountain Crest Brewing Company
- Richmond Hill Wines
- The Organic Wine Connection
- Trialto Wine Group Ltd.
- Vendemmia International Wines Inc.
- Vinissimo Ltd.
- Wild Rose Brewery
- WineQuest - Barbara & Susan Giacomin

Association - Downstream

- Alberta Hotel & Lodging Association
- Alberta Liquor Store Association
- Canadian Council of Grocery Distributors
- Canadian Restaurant & Foodservices Association
- Alberta Independent Liquor Retailers

Association - Upstream

- Beverage Alcohol Importers Council of Alberta
- Canada's National Brewers
- Spirits Canada

Freight Forwarder

- ContainerWorld
- JF Hillebrand

Warehouser

- Connect Logistics

Licensee - Independent

- 1 Stop Beer and Liquor
- Archive Wine Cellars
- Astoria Hotel
- Bin 905 Distinctive Wines & Spirits
- Casella Wines
- Crowfoot Liquor Store
- Crystal Ridge Liquor
- Flames Liquor Store
- Foothills Cold Beer Store
- Lucky Liquor Stores Ltd.
- Marda Loop Liquor & Wine
- Mission Wine & Liquor Merchants
- Plaza Liquor Mart Red Deer
- Quik E Mart
- Royal Spirits Liquor Store
- Sexsmith Liquor Store
- Sherbrooke Liquor Store
- Spirit Quest Liquor
- Spirits of Kensington
- Target Liquor
- The Wine Cellar
- Willow Park Wine & Spirits
- Wine & Liquor Store
- Wines & Spirits Warehouse

Appendix B – Alberta's Liquor Supply Chain Discussion Paper

Alberta's Liquor Supply Chain

Discussion Paper

GAMING AND LIQUOR
COMMISSION

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Discussion Paper
Alberta's Liquor Supply Chain

1. Introduction

The receipt of liquor product from suppliers and agents, and the distribution of liquor product to licensees from the Connect Logistics Services (CLS) warehouse in St. Albert have encountered a number of significant supply chain issues over the last several months. These supply chain factors have caused issues for suppliers, agents, and liquor licensees, and attracted licensee and media attention.

The issues related to the liquor supply chain include:

- The external factors impacting the liquor supply chain. These involve Alberta's strong economy, tight labour market, and growing population, which have contributed to labour-related challenges and unprecedented levels of liquor demand.
- The supply chain itself. These cover all aspects of the supply chain management process, including how products come into and are received in Alberta, how product inventory is managed in the Connect Logistic Services (CLS) warehouse, and how products are assembled and ultimately distributed to liquor retailers.

The purpose of the review is to better understand the issues surrounding the liquor supply chain in Alberta, with a view to developing recommendations to improve the long-term effectiveness and efficiency of liquor warehousing and distribution in Alberta.

The discussion paper includes background on drivers impacting the liquor industry, an overview of the supply chain management process, issues surrounding the supply chain, and key questions for consideration. It is intended to stimulate suggestions to help establish long-term strategic direction for liquor warehousing and distribution in Alberta, and to improve operations now and into the future.

Key questions pertaining to various aspects of the liquor supply chain are located throughout the discussion paper. Not all questions will be relevant to all stakeholders. Please answer all the questions to which you wish to provide responses, and send your written submissions via mail, fax or e-mail by January 19, 2007 to:

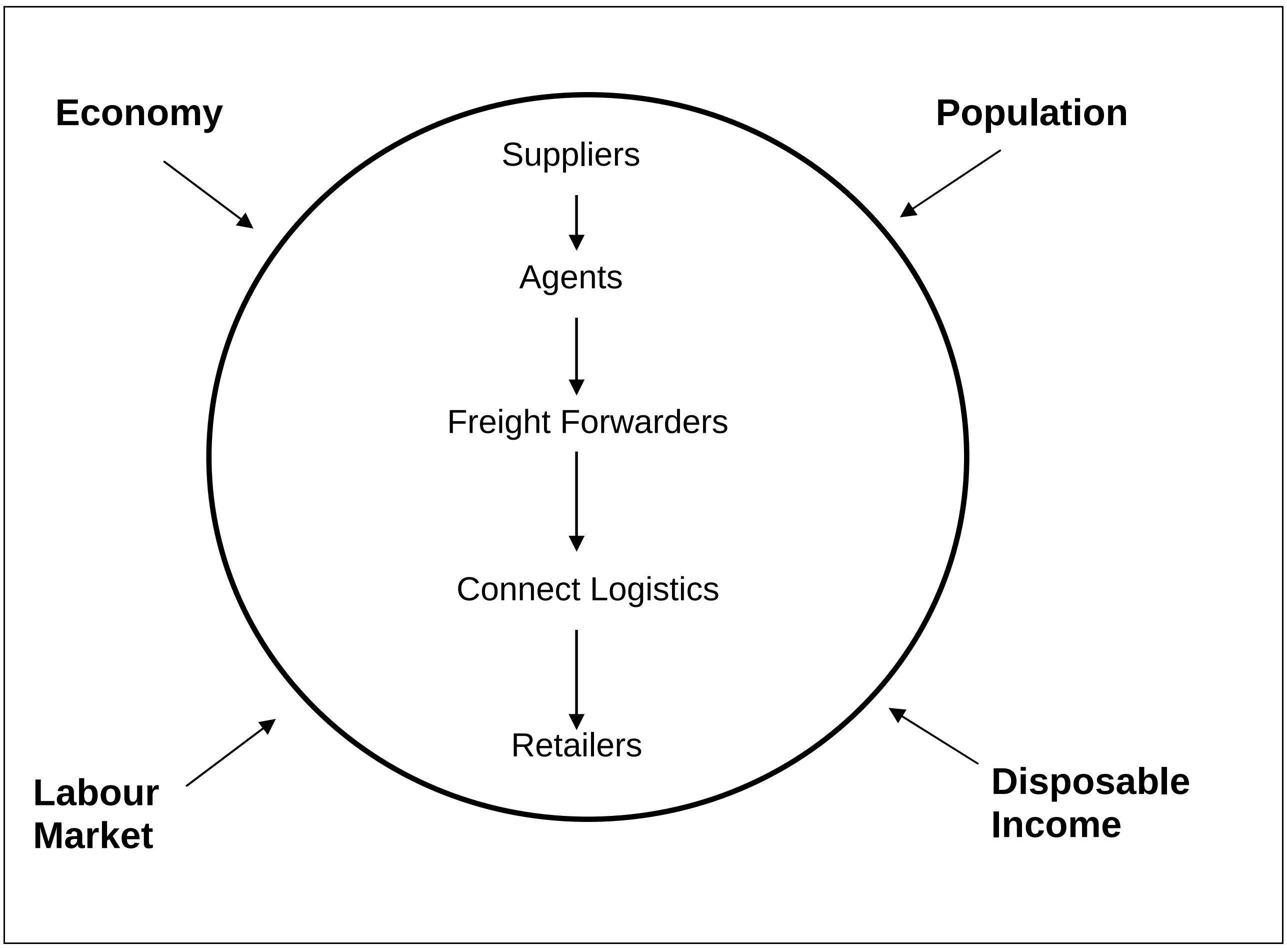
Alain Maisonneuve
Director, Strategic Services
Alberta Gaming and Liquor Commission
50 Corriveau Avenue
St. Albert, Alberta T8N 3T5
Fax: (780) 447-8933
E-mail: alain.maisonneuve@aglc.gov.ab.ca

2. Alberta's Liquor Supply Chain

The ordering, transporting, warehousing and distribution of liquor products takes place in the wider context of Alberta's society and economy. A range of external factors, including labour market and economic conditions in Alberta and elsewhere, the number of people living in Alberta, the levels of their disposable income, and how they choose to spend that income, all have the potential to impact the liquor supply chain in Alberta.

The key relationships within the liquor supply chain, and some important external factors that impact that supply chain, are depicted in Figure 1 below.

Figure 1
Liquor Supply Chain



3. The External Context

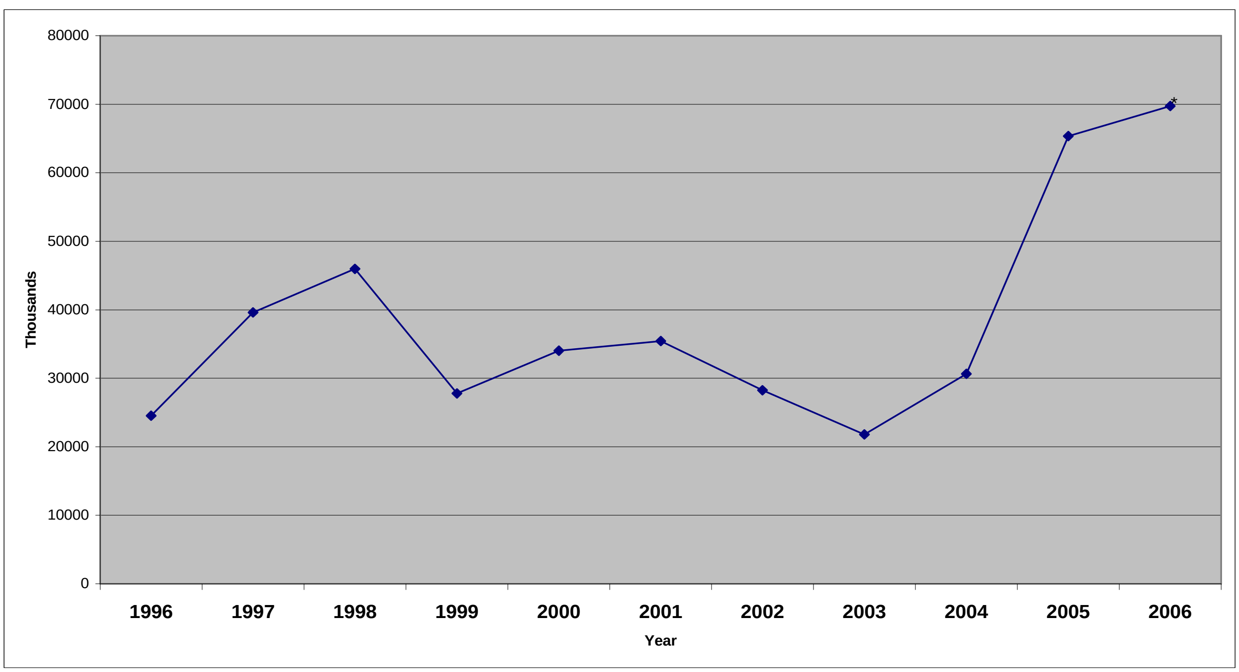
3.1 Alberta's Economy and Population

Alberta is currently in the midst of the strongest period of economic growth ever recorded by a Canadian province. Statistics Canada reports that between 2002 and 2005, Alberta's total GDP rose an average of 12.7 percent a year, placing it on par with China, the current leader of global economic growth. The current economic conditions apply to both industry and individual Albertans. Albertans' wages have grown steadily since 1997, with average weekly earnings increasing over 14 percent between 2004 and 2006.

Higher employment income translates into greater discretionary income, and Statistics Canada indicates that Albertans now have the highest per capita personal disposable income in Canada (21 percent higher than the national average), along with the highest consumer spending. Albertans' spending on consumer items, which rose 4 percent annually from 1998 to 2003, increased 5 percent in 2004, and 7 percent in 2005. As of September 2006, retail sales were up 17 percent over 2005.

The strong economic climate has attracted many people to the province. Alberta's population as of July 1, 2006 was 3,375,763, up 3.0 percent from a year earlier, a growth rate that continues to be the highest among all provinces. Net-migration to Alberta, which generally rises and falls with economic and labour market conditions in Alberta and the rest of the country, is now at historic highs. Net-migration has steadily increased since 2003, with 21,798 people coming to Alberta in 2003, 30,661 in 2004, and 65,361 in 2005 (Figure 2). While 2006 data is available for the period of January to June only (34,865 thousand), if migration levels for the reminder of 2006 were to mirror those from the first half of the year, net-migration would stand in excess of 69,000 for 2006.

Figure 2
Alberta Net-Migration – 1996 - 2006



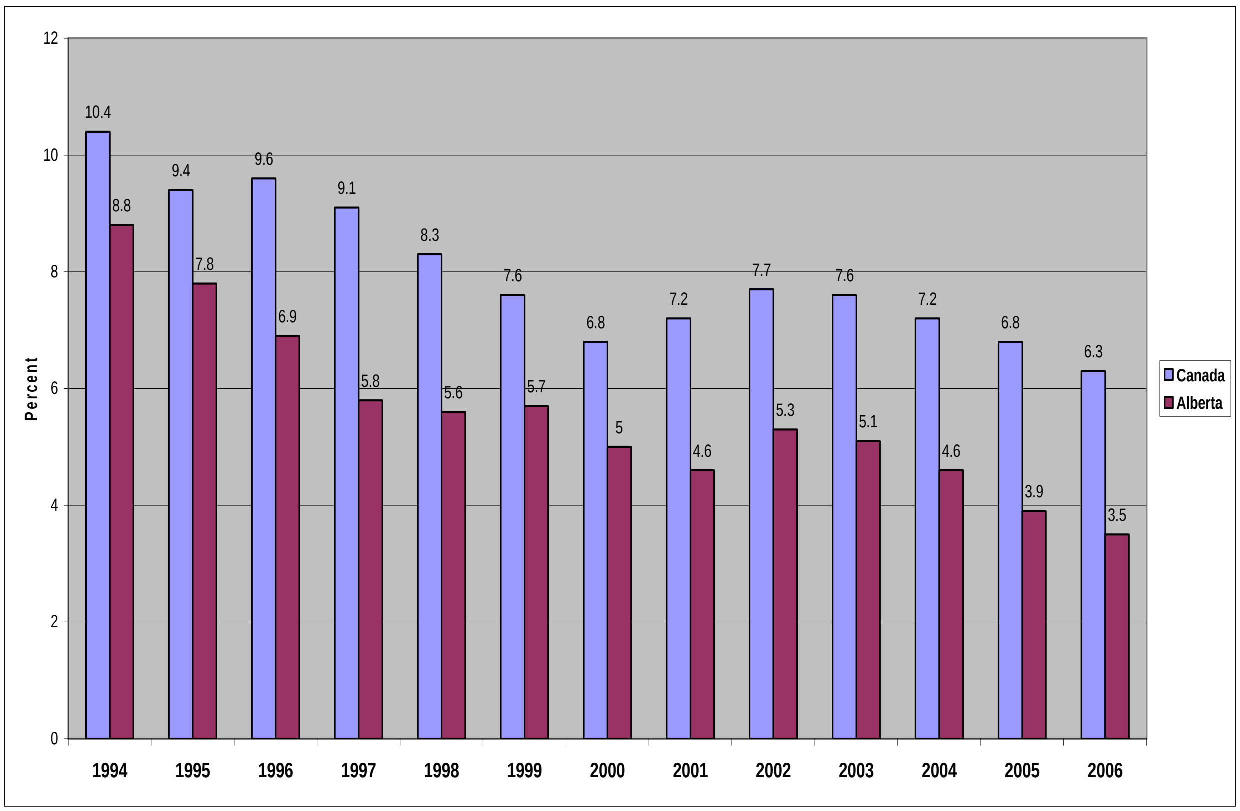
Source: Statistics Canada
* 2006 figure is an estimate only.

3.2 Alberta's Labour Market

Alberta's unemployment rate has been steadily declining for over a decade, with the province experiencing increasingly tight labour market conditions, especially since 2000 (Figure 3). At that time, the unemployment rate was 5.0 percent, dropping to 3.9 percent in 2005, and 3.5 percent for 2006 to date. Statistics Canada indicates that Alberta's 2.9 percent unemployment rate in June 2006 was the lowest of any province or state in North America.

These tight labour market conditions have persisted in spite of the high levels of net-migration to Alberta, creating strong competition for workers, and placing upward pressure on wages. Average weekly earnings in Alberta increased by 15 percent between 2004 and 2006 to date, and are now the highest in Canada.

Figure 3
Unemployment Rate in Alberta – 1994 – 2006

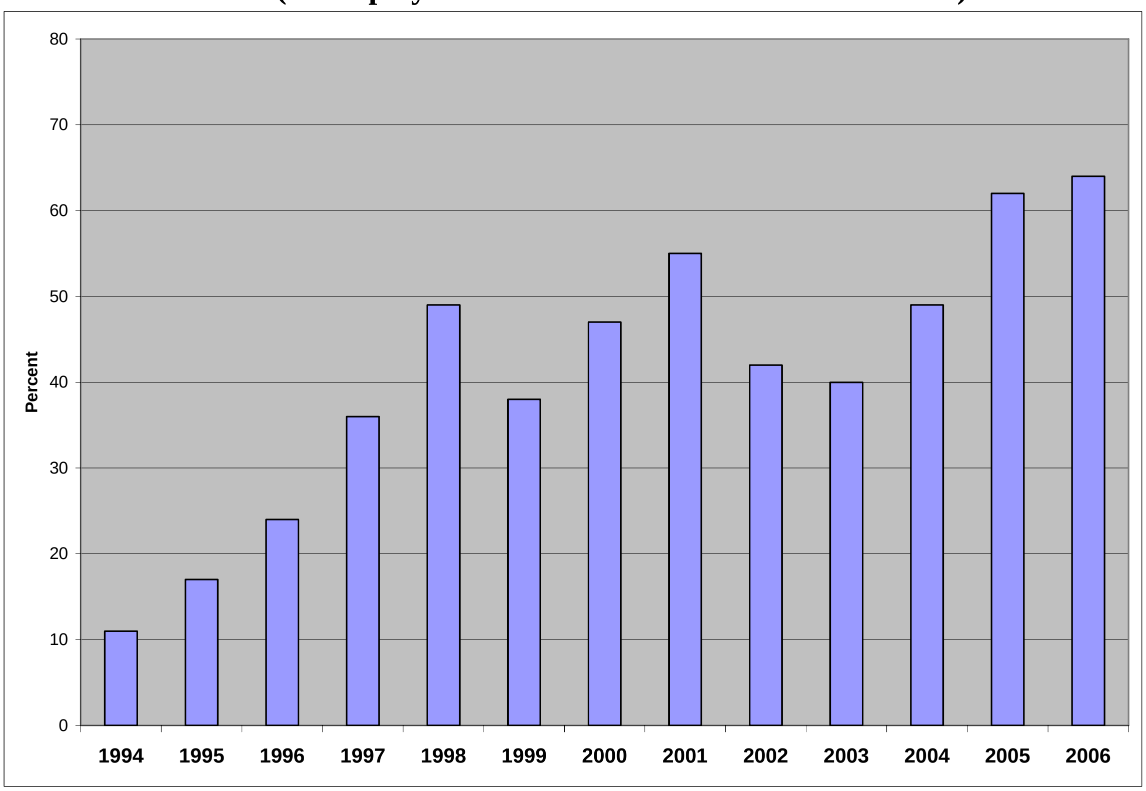


Source: Statistics Canada
* 2006 figures are for the first 10 months of the year.

An unemployment rate in the order of 3 percent is commonly considered to be indicative of a labour shortage. Since 2004, more than half of the occupations in Alberta have been experiencing shortage conditions. In 2006 to date, 34 of 53 occupational groups (64 percent) were in a shortage situation (Figure 4). These shortages are affecting a wide range of occupations and are evident across the entire province.

In the Warehousing and Distribution industry, which according to Statistics Canada's North American Industry Classification System, includes companies 1) that transport passengers by rail, water, air or road, 2) transport goods by rail, water, air, road or pipeline, or 3) warehouse or store goods, the unemployment rate in Alberta in 2005 was 2.5%. For 2006 to date, the unemployment rate is 1.6%, indicative of a severe shortage. Continued industry growth is expected, as are worker supply constraints. The Alberta Economic Development Authority predicts that growth in the Transportation industry will be highest for trucking, followed by rail.

Figure 4
Percentage of Alberta Occupational Groups with Shortages – 1994 - 2006
(Unemployment Rates of Less than Three Percent)



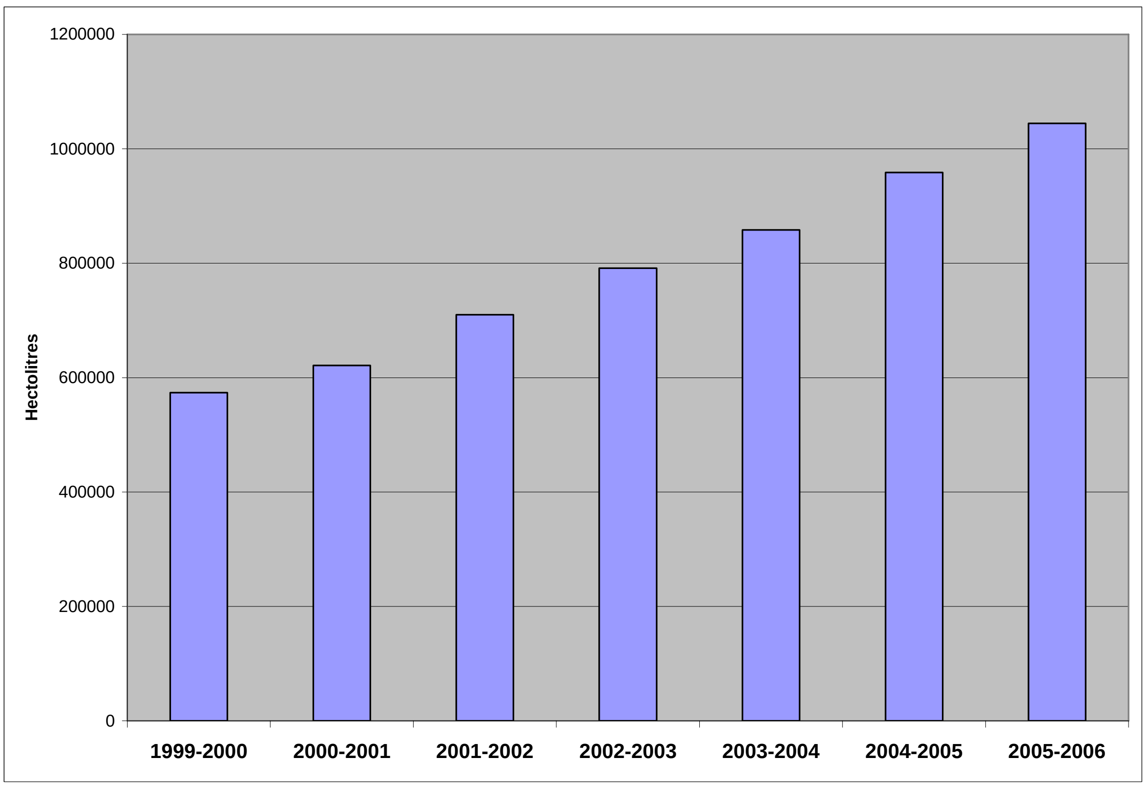
Source: Statistics Canada. Calculations by Alberta Gaming and Liquor Commission.
* 2006 figures are for the first 10 months of the year.

3.3 Increased Demand

The combination of more Albertans with higher levels of disposable income has contributed to an unprecedented demand for liquor products. The hectoliters of liquor product sold in Alberta increased from 2,545,951 hectolitres in 1999-2000 to 3,065,419 hectolitres in 2005-2006, an increase of 20 percent.

Increases of liquor distributed by CLS were even larger (Figure 5), with hectoliters ordered increasing from 573,704 in 1999-2000 to 1,044,195 in 2005-2006, an increase of 82 percent. As of October 2006, demand for liquor products through CLS had increased 13 percent from the same time the previous year.

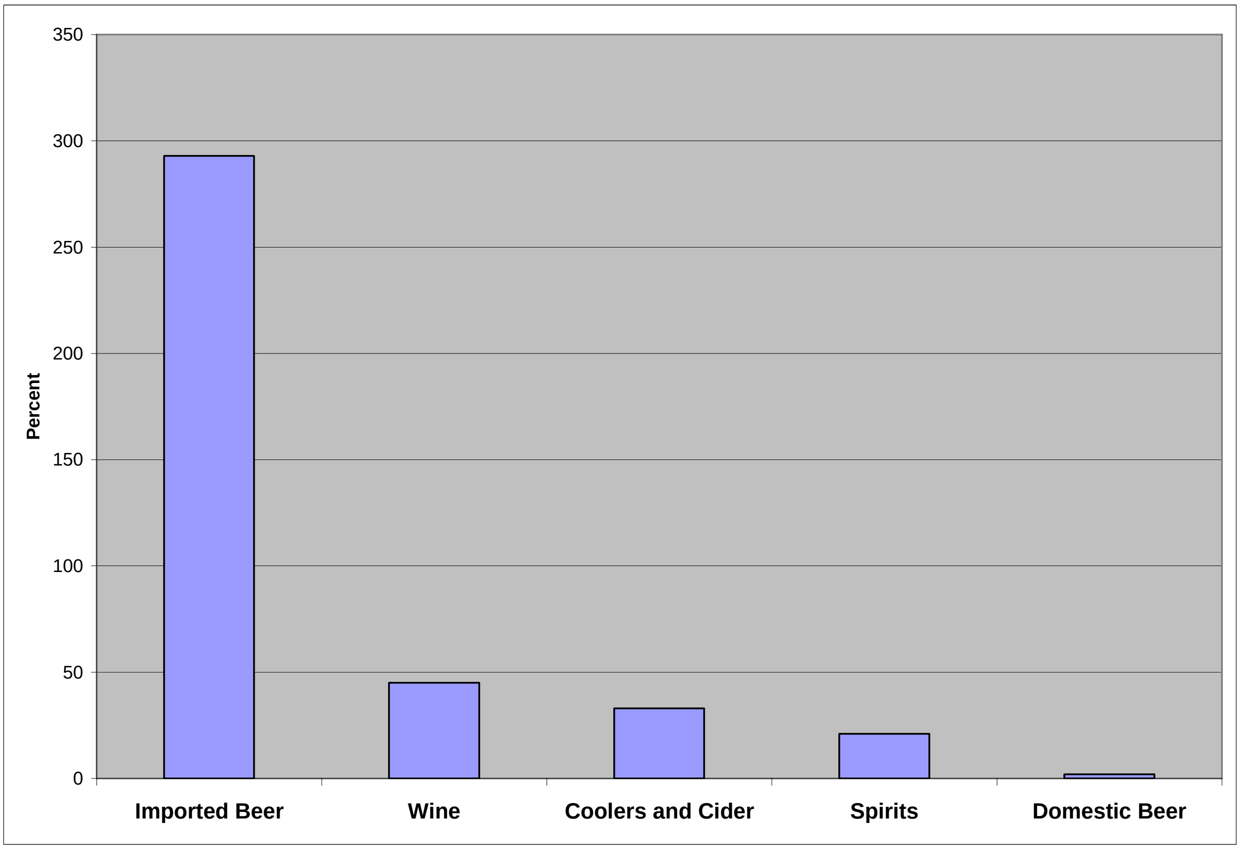
Figure 5
Hectolitres of Liquor Product Distributed From Connect Logistics
1999-2000 – 2005-2006



Source: Alberta Gaming and Liquor Commission

The nature of the demand has also shifted over time. As seen in Figure 6, consistent with trends across Canada, sales for imported beer have increased the most over the period between 1999-2000 and 2005-2006 (293 percent), followed by sales for wine (43 percent), sales for coolers and ciders (33 percent), sales for spirits (21 percent) and sales for domestic beer (2 percent). Given that CLS is the warehouser and distributor of wine, spirits, imported beer, and coolers and cider, the changes in demand for liquor products have had a greater impact on CLS than on the warehousers and distributors of domestic beer in Alberta.

Figure 6
Percentage Increases in Sales of Wine, Spirits, Beer, Coolers and Cider
1999-2000 – 2005-2006



Source: Alberta Gaming and Liquor Commission

The volumes of liquor ordered by retailers are also seasonal, with generally lower volumes in January and February, and higher volumes in the May/June and October/November periods. In general, during an average week, approximately 200,000 cases of liquor would be ordered from CLS. In 2005, the highest number of cases ordered in one week was 279,000. In 2006 to date, volumes have been as high as 395,000 cases in a week (the first week of November 2006), the highest level in the history of the firm's operation.

3.4 Key Questions

1. To what extent are the issues surrounding the liquor supply chain the result of external factors such as the economy, population growth and increased demand? To what extent are the issues the result of factors specific to the supply chain itself? Please explain.

2. If issues surrounding the strong economy, labour shortages and increased demand did not exist, or if circumstances changed, would there still be challenges with respect to warehousing and distribution in Alberta? Why or why not?

3. Given the impact that external drivers, such as economic conditions and population growth can have on the liquor supply chain, how can we better prepare for the future?

4. The Supply Chain

Following the privatization of the liquor industry in Alberta in 1993, the private sector provides all liquor retailing, warehousing, and distribution functions in Alberta. CLS warehouses and distributes all spirits, wines, imported beers, and coolers and ciders. Brewers Distributor Limited (BDL) warehouses and distributes domestic beer products for Molson and Labatt. Sleeman Breweries Ltd. operates a distribution facility for their own products. In addition to CLS, BDL and Sleeman, there are also four small Class E beer manufacturers in Alberta that warehouse and distribute their own domestic beer products. This discussion paper focuses on CLS.

The AGLC is, under legislation, the regulator for liquor importing, warehousing and distribution, and is the importer of record for all liquor products coming into Alberta. As Importer of Record, the AGLC is the only entity that can release imported liquor product for sale in Alberta and is liable for all statutory obligations under the *Importation of Intoxicating Liquors Act*, the *Customs Act*, the *Excise Act*, and the *Excise Act 2001*.

Any beverage alcohol product brought into Canada must be imported through a bonded warehouse that is approved by the Canadian Border Services Agency and the respective provincial Importer of Record. A bonded warehouse allows international shipments to be received directly rather than having to be Customs released at the Canadian border crossing.

Supply chain management in Alberta's liquor industry involves several warehousing and distribution points and is a complex process. In contrast to the supply chain management processes in some other industries, no one entity oversees or coordinates the liquor supply chain as a whole. The main parties in the supply chain are ***liquor suppliers***, ***liquor agencies***, ***freight forwarders***, ***warehousers and distributors***, and ***retailers***. The main activities involve the:

- production of a liquor product by a liquor supplier;
- management of the demand chain by a liquor agency;
- transportation logistics by a freight forwarder;
- warehousing and distribution by a warehouser/distributor; and
- retailing of liquor products by more than 1,100 liquor stores in the province.

Due to the industry's complexities, and the fact that no one entity coordinates the supply chain, several factors at various stages of the supply chain can result in a disruption in the flow of liquor products into Alberta. To understand the possible disruptions in the process, it is first essential to understand the roles and responsibilities of the parties within the supply chain.

4.1 Liquor Suppliers

Liquor suppliers, in the context of Alberta's liquor industry, are the entities that manufacture alcoholic beverages. Liquor suppliers consist of breweries, wineries, and distilleries located throughout the world.

The major factors that affect liquor suppliers' production are the availability of raw materials, the efficiency of production processes, and the ability to access markets for their products. The availability of raw materials for production is typically dependent on agricultural factors, meaning that seasonality can become a factor in the supply chain. Efficiency of production processes relates to a supplier's desire to utilize resources in the most efficient manner. In order to produce liquor products most efficiently, production facilities, particularly distilleries, will produce, or “run”, one product at a time in a large quantity. These production schedules can have significant implications for inventory management by liquor agents. The location of product markets also influences the supply chain because it shapes the way in which goods are transported. For example, a product from the United Kingdom would likely arrive in Alberta in a different way and from a different location, than a product from Australia or Mexico.

4.2 Liquor Agencies

Liquor agencies are the entities that are primarily responsible for inventory management, sales, and product promotion. Liquor agencies typically represent more than one liquor supplier’s products. Liquor suppliers may also have more than one liquor agency.

Liquor suppliers and liquor agencies enter into an agreement, whereby the liquor agency agrees to provide services to the liquor supplier to get its product to market in the most expedient fashion. The AGLC retains records of product representation in Alberta by requiring liquor agencies and liquor suppliers to sign and submit a declaration.

Once liquor agencies have taken on a product line, they manage the local supply chain in their jurisdiction with respect to purchasing product. This process involves contracting a freight forwarder to import a product from its place of origin into Alberta. As well, the liquor agency manages sales and marketing to drive demand for the liquor supplier’s product.

4.3 Freight Forwarders

Freight forwarding companies are hired by the suppliers or agents to transport liquor products from liquor suppliers to warehouses and local distribution centers. In Alberta, there are two major freight forwarders conducting operations in the province: ContainerWorld and J.F. Hillebrand.

ContainerWorld holds the largest share of the imported freight forwarding market and operates exclusively in Alberta and British Columbia. In addition to being a freight forwarder, ContainerWorld is also involved in the warehousing and distribution industry in British Columbia. Since it receives products for both British Columbia and Alberta, ContainerWorld typically ships loads to Alberta that have been consolidated in their Vancouver warehouse through other freight forwarding companies.

J. F. Hillebrand specializes in beverage alcohol products exclusively. Purchase orders are transmitted to the local/regional export office where the supplier is located internationally. The export office then makes contact with the liquor supplier who would likely have been notified by the liquor agency that it had issued a purchase order. The product is then picked up from the liquor supplier and taken to a local warehouse where it is consolidated with other liquor agencies’ products.

For domestic orders, liquor agencies or suppliers typically arrange for a trucking company to be the freight forwarder to move their product. Domestic freight is primarily handled by the major rail companies or J. F. Hillebrand, each of which have separate agreements with liquor agencies and trucking companies to bring loads directly to CLS for unloading. For products from overseas where trucking is either not possible or not feasible, freight forwarders deal with steamship lines that can transport products from port to port. The freight forwarding process concludes when liquor products have been received by CLS.

4.4 Connect Logistics Services Ltd. (CLS)

In June 1994, as part of the privatization of Alberta's liquor industry, the St. Albert Warehouse operations were transferred to the private sector. At the time of this decision, the central warehouse model was chosen to avoid: 1) the increased costs to suppliers, retailers and consumers from having multiple warehouses; 2) the increased administration, auditing and monitoring of liquor products that would be required in a multiple warehouse system; 3) the increased complexity for retailers (e.g. ordering, paying for, and receiving products from multiple locations), and 4) the potential negative impact on liquor selection and choice. The decision supported one of the key principles of liquor privatization, that cost changes to the consumer would be minimized.

CLS is authorized to be the agent responsible for the warehousing and distribution of spirits, wine, imported beers, and coolers and ciders in Alberta. CLS began as a division of Tibbett and Britten, and is now part of the Exel Group. CLS operates a 430,000 square foot distribution centre, with an automated storage and retrieval high rack system that can store more than one million cases of product in 21,000 pallet positions. It recently added 4 warehouses for liquor storage, bringing total storage capacity for liquor products to 700,000 square feet. The warehouse currently receives almost 13,000 liquor products on behalf of about 230 liquor agents representing 2,000 liquor suppliers from over 70 countries. Once products are received, CLS takes product orders from licensed Alberta liquor retailers (licensees), then assembles and ships those orders to over 320 communities throughout Alberta. CLS contracts 12 carriers to ship over 10 million cases of liquor products per year to more than 1,500 Alberta licensees.

4.5 Ordering and Payment Policies

All retail clients ordering through CLS are assigned scheduled days to order liquor products. Depending on the size of retailer, the number of order days ranges from one day a week to several days a week. The geographic location of the retailer determines both the order day(s) and day(s) of delivery. Prior to the delivery delays that occurred in 2006, delivery of orders to retailers took place 24 to 48 hours after the order had been placed, depending on the location of the liquor retailer in the province. Retailers are also able to place additional non-scheduled orders for liquor products at an additional charge.

In consultation with the liquor industry, CLS put in place a minimum order quantity of 25 cases per order. This allows liquor transportation costs from the CLS warehouse to Alberta liquor licensees to remain at a reasonably low level. With approximately 8,000 licensed establishments in the province of Alberta, there are only about 1,500 licensees who order directly from CLS. Other liquor retailers purchase their products directly through Class D liquor retailers, which allows for equitable access to liquor products in all areas of the province

As required by Section 80 (3) of *Gaming and Liquor Act*, the AGLC must not deliver liquor products until the purchaser has paid for the liquor. Historically, all licensees had paid, directly to the AGLC, the wholesale price for products ordered from the CLS facility on the day they placed their orders. As of August 2006, the AGLC has collected liquor order payments on the day that retailers have been advised that their orders will be shipped. Section 80 (2) of the

Gaming and Liquor Act also states that all products must be sold at the same price to all licensees. This eliminates any volume discounting and ensures that the smallest retailer in rural Alberta is afforded equal access to the products at the same price as the largest urban store.

4.6 Warehousing/Receiving

As a warehouser, CLS works directly with freight forwarders to schedule the receipt of shipments which are stored in the St. Albert warehouse. Suppliers or agents can ship as much product as they wish to the CLS warehouse. All purchase orders for liquor products indicate an estimated time of arrival so CLS can plan for inbound shipments. Large freight forwarders (e.g. J.F. Hillebrand and ContainerWorld) are allocated a specified number of receiving appointments per week based on historical sales. All other freight forwarders are given appointments on a first come, first served basis.

The CLS warehouse is a bonded warehouse, which means that products can clear Canadian customs within the facility. As a distributor, CLS takes orders from Alberta liquor retailers, and ships liquor products to them within a specific timeframe. CLS has 18 bays dedicated to receiving loads, 14 bays dedicated to shipping liquor products to retailers, and a bonded container yard.

4.7 Delivery of Liquor Product to Retailers

All Alberta liquor licensees that purchase product through CLS pay a flat “postage stamp” rate for product to all delivery points in the province and thus no liquor licensee pays a higher or lower delivered price for liquor products due to geographical location. The liquor industry requested this postage stamp model during privatization. The revenue generated from providing receiving, storage, distribution and other special services covers the warehouse operating costs.

4.8 Retailers

The operators of retail liquor stores can stock whichever products in whatever quantities they choose. This freedom of choice on the part of the individual operators has resulted in a diverse range of in-store product selection. Some stores focus on a smaller selection of volume-selling brands, while others offers a wider array of different products.

4.9 Key Questions

4. Are the roles and responsibilities of all participants in the supply chain clear? Are all the parts working together effectively? How could this be improved?

5. Given that, currently, no one entity is in control of the entire liquor supply chain, how can each part work together to ensure a successful outcome for the supply chain as a whole, not just for the part that a particular entity (e.g. an agent, freight forwarder, warehouse, etc.) is responsible for?

6. Would there be merit in having one entity coordinate the entire liquor supply chain? What entity could do this? What roles and responsibilities would this entity need to have? What implications would this have on the free market model used in Alberta?

5. Issues Surrounding Liquor Supply Chain Management

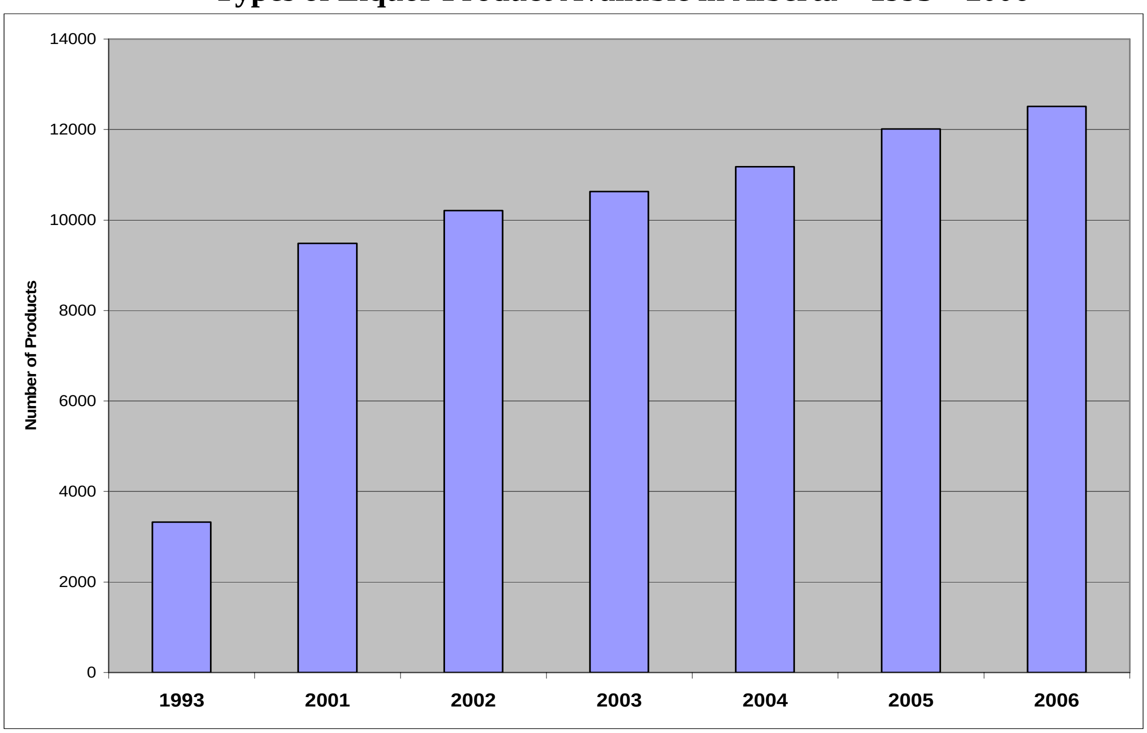
The previous section described the key areas in the supply chain management process and the roles and inter-relationships of these parts. This section focuses on the current situation, including the recent trends and developments that have impacted the liquor supply chain in Alberta.

5.1 Products and Inventory

5.1.1 - Increases in Volume and Diversity of Products -The volume of orders received by CLS has increased significantly over the last several years, with the number of hectoliters ordered in a year now standing at over 1,000,000 (2005-2006).

There are also more types of products available to be ordered. As of March 2006, there were 21,554 liquor products listed, with nearly 13,000 products being available at any one time, compared to 3,325 products available in September 1993 (pre-privatization), an increase of nearly 300 percent. Between March 2001 and March 2006 alone, the number of product types available in the CLS warehouse increased 32 percent (Figure 7). In the week of November 10, 2006, CLS reported that there were 15,304 types of liquor products available (in or en route to the CLS warehouse): 11,520 wine listings, 2,843 spirit listings, 648 imported beer listings, and 293 cooler listings.

Figure 7
Types of Liquor Product Available in Alberta – 1993 – 2006



Source: Alberta Gaming and Liquor Commission
* Data are for March 31 of each calendar year.

As of November 2006, the warehouse inventory stood at 2.4 million cases. Last year at the same time there were 1.8 million cases (an increase of 33 percent). While the increased volume and diversity of products available are indicators of a robust liquor industry, they have placed pressure on many aspects of the supply chain, both because of the sheer volume of product and because of the complexity that an increasing number of products introduce to the supply chain. These pressures have had a strong impact on receiving liquor products at CLS, on assembling the products for orders, and on delivering the products to retailers.

5.1.2 - Slow Moving Products – Many types of liquor products are brought into the CLS warehouse by liquor agents. Some of these products move through the warehouse quickly, being ordered by liquor retailers soon after they arrive. However, other liquor products which have more of a specialty market (e.g. wines) may stay in the warehouse for an extended period of time. Although having these products available to retailers and ultimately consumers supports the goals of the privatized liquor model, having liquor products that turn over slowly contributes to congestion in the warehouse. When the CLS warehouse had excess capacity, this was less of an issue, but any amount of slow moving product adds to the already large volumes in a capacity constrained environment.

5.1.3 - Out of Stock Product (Stock Outs) - Most suppliers have increased their inventory of liquor products in 2006. However, some suppliers have reduced inventory, resulting in products that are out of stock. Retailers have reported difficulties in ordering certain liquor products. Related to this issue, when product which has been out of stock arrives in the CLS warehouse, there have been instances where some larger retailers have purchased large amounts of the product that has come in, reducing or eliminating the stock available to other liquor retailers. Some stakeholders have also reported instances where agencies are notifying particular liquor retailers of products that are to become available, and then inventory of these products is depleted before other retailers can order them.

5.1.4 - Ordering – The current policies for ordering liquor products are having unintended impacts on available stock and, some would suggest, equitable access to liquor products. Larger retailers have more order days than smaller liquor retailers. There are instances where large retailers may have a sufficient number of order days in a week that they have the ability to significantly deplete the number of products available to other retailers. In addition, even though all liquor retailers have a scheduled day or days for ordering liquor products for most of the year, they can order on a non-scheduled day if an additional cost is paid. In general, larger retailers have a greater ability to pay and absorb the additional costs associated with ordering on non-scheduled days. There have been instances where larger retailers with multiple stores have been ordering earlier in the week, in advance of the scheduled days of smaller retailers, and reducing the availability of stock available to smaller retailers.

5.1.5 - Limited Time Offers – Some liquor products are offered to retailers at a reduced price for a fixed amount of time, and are referred to as limited time offers (LTOs). LTOs generally run for a two week period from Friday to Thursday. Where larger retailers order in advance of smaller retailers, there is the potential for larger retailers to order large amounts of the LTO stock, significantly diminishing or depleting the stock available to other retailers. From a receiving and warehousing perspective, large retailers who purchase the stock, but wish to wait to have it delivered, are paying to have CLS store their product, impacting the space available for receiving new shipments of product.

5.1.6 Key Questions

7. Albertans have access to a wide range of liquor products, where the market decides which products are ultimately available. Some have suggested that the number of different types of products available to be sold is affecting the level of service offered, and that a limit to the number of products warehoused and offered for sale would be beneficial. Others have indicated that slow moving products should be segregated (perhaps in a separate warehouse) and be available only at reduced service levels. To what extent would you agree that the number of liquor products should be managed? What do you see as the benefits and challenges of limiting the number of products available? How effective do you think limiting or managing the number of products would be in solving the issue of ensuring effective and efficient delivery to liquor retailers?

8. If product limits were introduced, who would manage these limits, and what criteria would be used to manage these product limits? What consumer reaction would be expected if such a measure were implemented?

9. Some have suggested that the current method for placing orders for limited time offers (LTOs) creates an unfair situation that works to the advantage of larger retailers. Do you believe this is the case? If so, what would you suggest to improve the situation to ensure a level playing field for all licensees?

10. Some liquor products are warehoused for longer periods than others. Should there be some rules in place to ensure that all products are moved through the warehouse, from receiving to delivery to retailers, in a timely fashion? If yes, how would you envision this working? Who would enforce these rules and how? What would be the implications of introducing such rules?

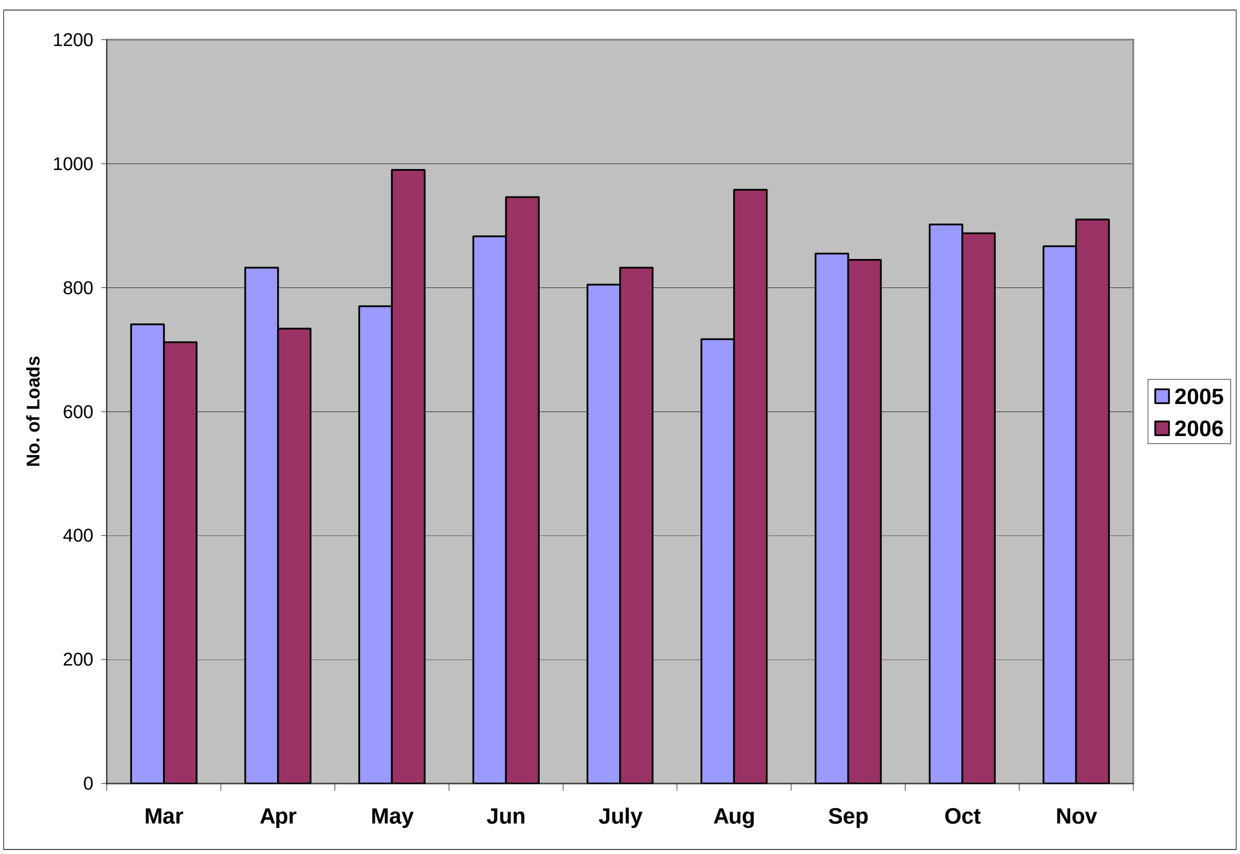
11. Is temperature-controlled storage an issue at all? Would you be willing to pay more to have more products warehoused in a temperature-controlled environment?

5.2 Receiving Liquor Products

5.2.1 - Changes Impacting Freight Forwarders – Suppliers that ship large quantities of product at one time impact the supply chain at the front end. Recent large-scale mergers in the steamship industry have resulted in fewer options for freight forwarders in choosing ocean lines to ship products. Labour shortages in Alberta's trucking industry are also evident in other jurisdictions and are resulting in difficulties hiring and retaining truck drivers to deliver product.

5.2.2 - Number of Loads Arriving - Historically, there has been a seasonal pattern to the number of loads arriving at the CLS warehouse, with a higher number of loads arriving in April, June and July (attributable to the need to have stock available for the summer season), and during October and November (attributable to the need to have stock available for the Christmas season). While that seasonality pattern still generally held in 2006, inventory levels were generally higher, with loads received in May and August of 2006 being 29 percent and 34 percent higher respectively than loads for the same months in 2005 (Figure 8). This has resulted in a shifting of the balance between the volumes being shipped to CLS and those ordered by retailers. Since August 2006, the volumes being received by the warehouse have been considerably larger than those being shipped out. As such, as of November 10, 2006, the inventory at the CLS warehouse stood at a record 2.4 million cases, up from 1.8 million cases at the same time one year earlier, an increase of 31%.

Figure 8
Total Loads Received by CLS between March 2005 and November 2006



Source: CLS

5.2.3 - Difficulties Receiving Shipments – Over the last few years, some stakeholders have reported difficulties getting liquor products into the CLS warehouse in a timely fashion for an approximately six to eight week period during the October/November timeframe. Consistent with the record incoming liquor volumes in May and August of 2006, difficulties receiving products into the warehouse began in the spring of 2006. This resulted in a backlog of containers waiting to be unloaded, difficulties in scheduling a sufficient number of delivery appointments at the CLS warehouse, and impacts working their way back through the supply chain, such as products needing to be stored at rail yards resulting in millions of dollars in demurrage charges being billed to freight forwarders (see discussion on demurrage on the next page), and products being temporarily stored in freight forwarders' warehouses.

5.2.4 - Scheduling Inbound Shipments – When agents and suppliers send purchase orders for liquor products to the CLS warehouse, an estimated date of delivery is indicated so that the CLS warehouse can plan for the inbound shipments of liquor. While this provides a general time frame in which the shipments may be expected, the arrival times of liquor shipments transported via trucking companies can be predicted with much greater precision than orders transported via train. In addition, shipments arriving by rail can be much larger than shipments arriving by truck, creating a situation where very large rail shipments may arrive at the same time, resulting in substantial volumes to unload into the CLS warehouse. The difficulties resulting from such a situation are magnified in an environment of increased liquor volumes and constrained capacity at the CLS warehouse.

5.2.5 - Unscheduled Inbound Shipments – There are numerous instances where unscheduled inbound shipments arrive at the warehouse, creating significant volumes that have not been planned for. When volumes are lower, and there are fewer pressures on the CLS warehouse, unscheduled deliveries can usually be accommodated with minimal disruption, but this has not been the case over the last several months. CLS traditionally places a temporary suspension on all unscheduled orders in advance of the Christmas season. This year, the suspension date was moved up to October 10, 2006, to ensure that orders are able to be picked and shipped to retailers. Additional appointments have been scheduled for some freight forwarders to deliver liquor products to the warehouse.

5.2.6 - Communication Issues – In a supply chain where no one entity oversees the entire supply chain management process, communication among the various parts is critical. Over the last several years, there have been communication difficulties among agents, suppliers, freight forwarders and the CLS warehouse regarding delivery into the CLS warehouse. The issues revolve around the planning, coordination and scheduling of liquor products into Alberta and the CLS warehouse. These challenges have now been exacerbated by increased volumes and capacity-related constraints at the CLS warehouse.

5.2.7 Key Questions

12. In your view, what is the key issue that has caused the backlogs in receiving at the CLS warehouse?

13. Given that the backlog in receiving is not acceptable, what improvements would you suggest making in the receiving process? How would you envision such a system working?

5.3 Warehousing

5.3.1 - Warehouse Space - Warehouse space at CLS in St. Albert is at capacity. To increase the capacity needed to address increased volumes, CLS added four liquor storage facilities, with the most recent one coming on stream October 2, 2006. Total warehouse storage space now stands at 700,000 square feet. A container yard was also put in place to help alleviate the bottleneck of incoming shipments which were contributing to increased demurrage charges (see the discussion on demurrage below). However, since only the main CLS facility in St. Albert is used for picking and assembling orders, liquor products from other storage facilities must be shipped to the CLS distribution centre, which entails unnecessary double and triple handling of product before the picking and assembling of orders to retailers.

5.3.2 - Warehouse Operations – Related to capacity constraints and the need to meet retailer demand, practices have been put in place for which the CLS warehouse was not originally designed. For example, the high racks in the warehouse were designed to be used for the storage of liquor products. However, due to the amount of inventory in the warehouse, there have been instances where these high racks have had to be used for picking products that are being assembled into orders for retailers. In addition to the issues this causes with assembling orders (e.g. the mechanical stress on crane equipment from overuse), using these high racks for picking decreases the already constrained capacity of the warehouse, since these racks can no longer be used to store liquor products that have been received. In addition, the cranes which receive liquor products and move them into inventory (the high racks) operate at a certain speed only. At the times where unprecedented volumes of liquor were being delivered to the warehouse, this speed was not sufficient to move the large amounts of received product into the warehouse without creating a backlog.

5.3.3 - Demurrage – This is a fee charged to freight forwarders by rail yards when containers of products remain in their rail yard longer than the allotted time. In early 2006, the time period CN permitted containers in their yard without a fee was three days, which subsequently decreased to one day. At three days, this allowed some flexibility in storing the product at the rail yard in the event that products were not able to be delivered to the CLS warehouse. When the time period moved to one day, products that were not able to be moved into the CLS warehouse incurred demurrage charges. In 2006, freight forwarders incurred millions of dollars in demurrage charges that were not anticipated, and it is not yet clear to what extent other participants in the supply chain may absorb some of these costs. To avoid these demurrage charges, there was increased pressure to ensure that inbound products were received and unloaded in as timely a manner as possible, further contributing to the pressures on the CLS warehouse. The new container yard near the CLS warehouse was built to help address this issue.

5.3.4 - Load Complexity - The number and complexity of loads being received at the CLS warehouse is seasonal. The complexity of a load, which translates into how easy or difficult it is to unload, determines how many loads can be received in a day. Complexity also affects the relative ease of assembling (picking) the orders that are to be delivered to liquor retailers. For example, loads and orders consisting primarily of pallets of beer are easier to unload into the warehouse and easier to assemble for delivery to retailers than are loads and orders consisting primarily of different types of wine and spirits. This is also the case in other provinces. However, given Alberta's privatized liquor model and the large number of products available, the complexity of loads is even more critical to the supply chain.

5.3.6 Key Questions

14. To what extent are the issues surrounding difficulties at the CLS warehouse stemming from challenges related to peak times of the year? How can sufficient flexibility be built into the system so that the supply chain functions efficiently, effectively and economically in peak periods and in low periods?

15. Some stakeholders have suggested that having more than one warehouse in the province would improve the effectiveness and efficiency of the liquor warehousing and distribution system. Do you believe that having an additional warehouse in the province would improve the current situation? If so, how?

16. If you have the view that another warehouse operation is needed in the province, would you envision this as an additional CLS warehouse, or a warehouse operated by a competing firm? Would you envision this warehouse as a full warehousing and distribution centre (like the St. Albert warehouse), or as a liquor storage facility only?

17. An additional warehouse operation would have costs associated with it, such as additional costs to agents and suppliers to have increased inventory, additional overhead to run two warehouses instead of one, and additional costs (e.g. trucking and handling) to deliver smaller loads. Do you think these additional costs would outweigh the potential benefits of another warehouse?

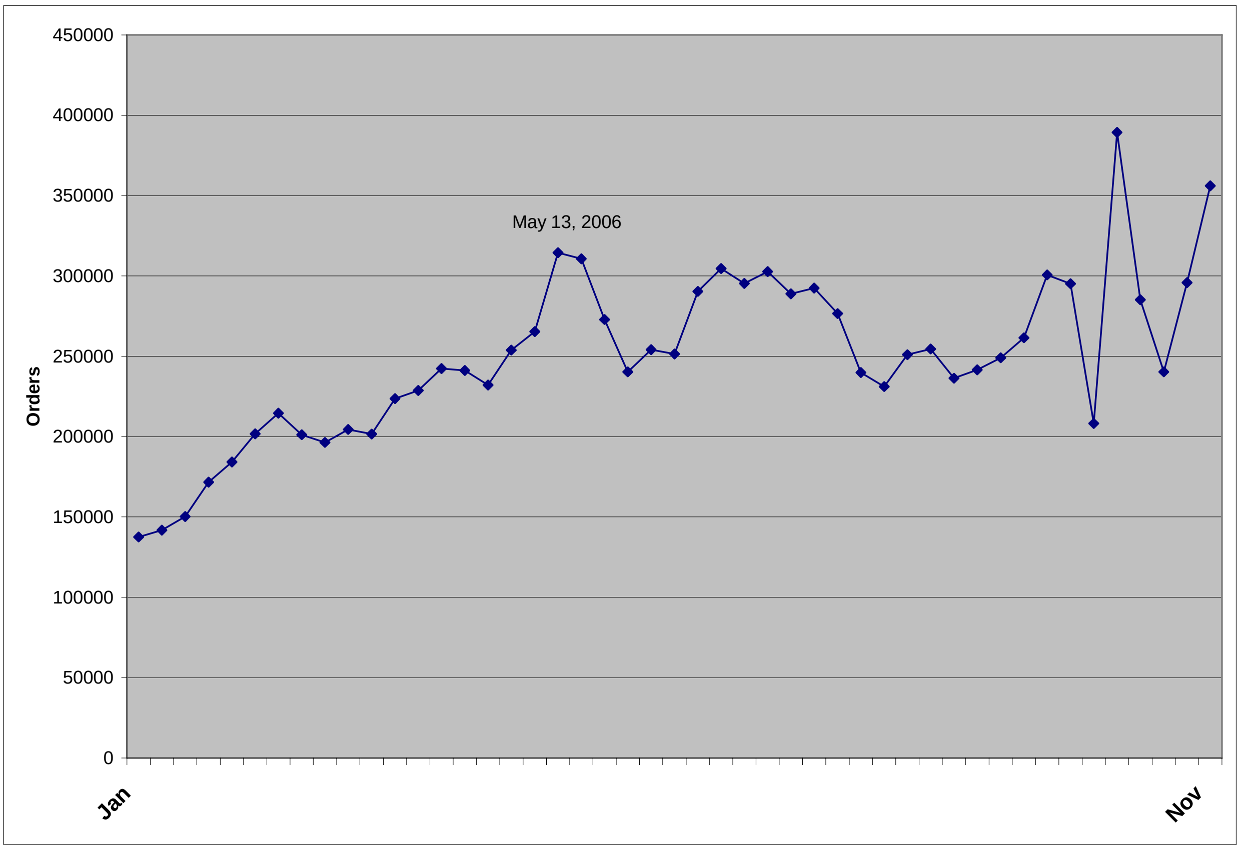
18. How would you envision such a warehouse working? For example, if there were a warehouse in the north and in the south, how would you ensure that all licensees would have all products available to them regardless of their location in the province? Would agents/suppliers be required to carry sufficient inventory in each warehouse? Would there be different LTO periods in different parts of the province? Would the same postage stamp rate continue to apply to deliveries to licensees? How would equal treatment of licensees throughout the province be ensured? Is equal treatment an important principle?

19. If there were one warehouse in the north and one in the south, how would you see this creating "free-market competition" between warehouses? Would each warehouse need to serve the entire province to ensure that licensees have choice? What effect would that have on agents' inventory (see above)? Would agents have to stock all products in both warehouses?

5.4 Delivery to Retailers

5.4.1 - Orders Received – At the same time that liquor volumes coming into the CLS warehouse have increased (from freight forwarders), the amount of liquor ordered by retailers has also increased. In 2005, the highest number of orders received from retailers was 279,000 cases, and was received in the week of December 24, consistent with pre-Christmas trends. In 2006, this 279,000 level was exceeded many times throughout the year, with the first instance occurring in the week of May 13, 2006 (Figure 9). These high order levels continued throughout most of the summer, decreased somewhat in August and September, and began to rise in the autumn, peaking at nearly 400,000 cases the week of October 28, 2006.

Figure 9
Number of Orders Through CLS



Source: CLS

5.4.2 - Days for Order to Arrive - Since CLS began operations in 1994, orders were delivered to retailers, on average, 24 to 48 hours after the products were ordered from the CLS warehouse, depending on their location in the province. However, over the last several months, liquor retailers in Alberta have experienced delays in receiving liquor products, due to delays in picking and assembling the orders, and to delays in having the orders delivered by trucks once assembled. The first late orders were experienced in April, and in June late orders had become the norm. Throughout the summer, products were being received by retailers five to six days after being ordered, increasing to seven or eight days in September, and then to eight to ten days in October. The situation generally improved throughout November and December. By mid December 2006, in most areas of the province, orders were being received by retailers three to four days after being ordered.

5.4.3 - Trucking Industry Issues - The labour shortages in the trucking industry that are impacting products coming into Alberta and the CLS warehouse are also having an impact on the delivery of products to Alberta liquor retailers. Part of retailer delivery delays are attributable to the backlog in picking and assembling liquor orders in the warehouse, and part are attributable to difficulties in finding trucks and truck drivers to deliver the orders once they have been assembled. Once assembled at the CLS warehouse, orders are generally taking 3 to 4 days to arrive at liquor retailers.

5.4.4 - Short Ships and Stock Outs - Some retailers have also reported difficulties receiving the liquor products that they have ordered, due either to "short ships" or to "stock outs". "Short ships" occur in instances where the product was available in the CLS warehouse, but was unable to be picked in time to be shipped with a retailer's order. These "short shipped" products are indicated on shipping forms, and retailers are credited for any products not received. "Stock outs" are not available from the supplier, and thus are not available in the CLS warehouse. As discussed earlier, retailers have reported difficulties in obtaining particular liquor products. These stock outs have generally had a greater impact on smaller retailers, since there have been instances where some larger retailers have purchased large amounts of previously out of stock product that has come in, reducing or eliminating the stock available to other liquor retailers.

5.4.5 - Retailer Impacts – Retailers have reported loss of revenue, negative impacts on customers, and difficulties in planning and scheduling staff for deliveries given the recent variability in delivery times. Larger and smaller retailers also have had differential ability to employ strategies to adapt to the recent challenges in receiving liquor products. In general, smaller retailers who might wish to order extra stock to have available as needed do not have the extra space required to store such additional stock. Recently, there have been instances where larger retailers have ordered additional stock and stored it in their own warehouses in anticipation of drawing on it as needed.

5.4.6 Key Questions

20. Are there processes related to the ordering of liquor products that could be improved? Which ones? How could this best be achieved?

21. To what extent is next day delivery a realistic expectation in today's labour market? What is a realistic order-to-delivery period? Is the delivery period the key issue or is it the certainty of the delivery date?

6. Summary

Supply chain management is a complex process involving many players. As discussed in the preceding pages, every aspect of the supply chain has experienced changes or issues, some ongoing and some new, that have combined to create challenges in the liquor supply chain. Taken together with Alberta's strong economy and rapid population growth in 2006, which resulted in unprecedented levels of demand, these issues have had a significant impact on warehousing and distribution, and the delivery of products to Alberta liquor retailers.

CLS has taken a number of steps to address these warehousing and distribution challenges, including hiring additional staff, increasing pay rates and overtime rates, creating incentive packages to retain staff, bringing in staff from other operations, operating the warehouse for longer hours (24 hours per day, seven days a week), scheduling additional shifts, increasing the number of carriers to deliver liquor products, and increasing communications with retailers to keep them informed of when orders will be delivered.

This discussion paper provides the background information to help build an understanding of the workings of the supply chain and the key issues surrounding it. It is intended to inform the discussion needed to build options to ensure the long-term success of warehousing and distribution in Alberta.

7. Questions to Stakeholders

The discussion paper presents information on the external factors impacting the supply chain, the supply chain itself, and the issues surrounding various parts of the supply chain. Please answer the following questions about the discussion paper.

A. Does the discussion paper cover all of the issues relevant to the liquor supply chain in Alberta? Are there any issues that you would add? If yes, how would you describe the issue? How would you address it?

B. Are there any issues described in the paper that are not relevant to the discussion? Which, if any, do you believe are not relevant?

C. Are we asking the right questions about the liquor supply chain? Which questions, if any, would you add? For any questions added, how would you answer the question? Which, if any, would you remove?