

# Ontario's Craft Beer Industry: Current Assessment and Future Directions

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## Abstract

The micro-brewing, or craft brewing industry, is a rapidly emerging section of Ontario's economy and local food system (Agriculture & Agri-Food Canada, 2015; Beer Canada, 2016). Since the late 1980s, over 300 breweries have opened shop in Ontario. The growth of the industry is interesting for a number of reasons. The government control of beer and alcohol sales in the province has created a number of challenges for small scale brewers, challenges only now beginning to shift. Historically, the beer industry has been defined by the consolidation of three major industrial scale brewers who control at least 80% of the market. The growing craft sector has pulled local agriculture toward commercial hop production, and opened up discussion of grain sourcing and processing. The trend toward local consumption has created a broader dialogue that questions the dominant corporate and government controlled framework of beer and alcohol sales in Ontario. The industry's recent growth also appears to, in part, be related to the broader local food movement.

This paper offers an interdisciplinary discussion on the emerging industry. It relies on three major lenses to offer a current assessment of the industry and the experience a brewing entrepreneur has in Ontario at present. First, it looks at the craft brewing industry within the framework of the local food network in Ontario. Second, this paper places the small to medium enterprise (SME) network of the micro-brewing industry within the framework of the Green Economy, which sees SMEs as having a pivotal role. It also seeks to understand the role of SMEs in contributing to a low-growth, or steady-state economy as outlined by Victor, 2008. Finally, this paper approaches the industry at the individual company level, examining business practices and sustainability therein. The approach taken by this paper is useful in understanding the functional and operational challenges and successes food SMEs have in carrying out their place within the green economy and local food system.

This paper contributes a new perspective to the limited existing literature on the craft beer industry in Ontario, and by extension the emerging role of SMEs in the growing local food sector. By undertaking analysis of four distinct breweries of various life-spans and scale, it assumes some common challenges or successes the brewing entrepreneur would find in this sector. The major questions addressed in this paper are: what role do SMEs have to play in the local food movement in Ontario; what are their entrepreneurial limitations or strengths under the current system, and by extension, what are their capabilities in integrating sustainability into their business practices?

Lastly, the findings highlight patterns and trends, and offer some recommendations regarding the future of craft in the Province and some speculations on leveling the playing field of the retail sales channels systems. Results show that craft brewing entrepreneurs are committed to maintaining independence and autonomy over their businesses, are driven by passion for the craft and are mindful of growing their businesses responsibly. Many of these entrepreneurs are highly conscientious and critical of growing too large, and aim to integrate ethics and sustainability into their business practices in response to the glaring issues corporate consolidation has created for themselves and the economy.

## Foreword

This Major Paper is the final document to satisfy the requirements of my Plan of Study in the Master in Environmental Studies program, Business and Environment stream in the York University Faculty of Environmental Studies. The paper is an interdisciplinary assessment of the craft beer industry in Ontario, which utilizes four case studies of Ontario craft breweries. It draws on the three components of my Plan of Study: 1) Sustainable Business Practice; 2) The Green Economy & Low Growth Economics, and; 3) Sustainable Local Food Systems.

Component #1, 'Sustainable Business Practice', was satisfied by my engagement with beer industry entrepreneurs, a number of whom bring sustainability to their business strategies. For those that did not as a core strategy, I was able to assess what factors contributed to integrating environmental concerns into business operations. I particularly addressed both learning objectives 1.1) Basic business strategy and thinking and 1.3) 'Understand how businesses can work toward both mission driven and profit driven gains without compromise.

Component #2, 'The Green Economy & Low Growth Economics' is concerned with the alternative economic frameworks which seek to see the economy function within resource constraints, and a macro economic framework that promotes prosperity and wellbeing over uncapped GDP growth as the end goal. I was able to address this component with this major paper extensively; craft brewing SMEs are often critical of growing too large as they have experienced friction and limitations as new market entrants in an industry that was built on business-as-usual economic values, i.e., one that has historically privileged industrial economies of scale, heavy foreign investment and commodification of its core product. They seek to benefit their local economies and often see firm growth as secondary to business ethics and integrity. I particularly satisfied learning strategy 2.3) 'Explore the possibilities in small scale local business.'

Component #3, 'Sustainable Local Food Systems' was addressed through an assessment the craft beer industry as a cluster of firms functioning within the local food system. The growth of the craft beer industry in Ontario has stimulated growth in the agricultural hop growing industry, as well as dialogue surrounding grain procurement in Canada. Strategy 3.1) 'Gain an understanding of business and economic frameworks for understanding the food system' was satisfied through discussing the challenges in ingredient sourcing, and provided context for the entrepreneurial challenges facing food system SMEs.

## Acknowledgements

I would be remiss not to acknowledge the assistance and support of several individuals in helping me complete this major paper. To my supervisor, Rod MacRae, for working closely with me since my re-entry to the MES program, helping me cultivate my ideas, and for your patience and input. To my advisor, Anders Sandberg, I am grateful for your input on my Plan of Study throughout my time in FES. To my interviewees: Steve Beauchesne, Jeff McCauley and all other Beau's staff I spoke to; Gary McMullen, Kristin MacDonald, Todd Lewin at Muskoka; John Graham at Church-Key and Graham Spence at Block Three Brewing Co.: I am deeply appreciative that you set aside time in your hectic brewery days to chat and share your insights on the industry. Your contributions made this paper what it is. Ken Woods at Black Oak Brewing Co., thank you for making yourself available for clarifications and for being so friendly. To Erica Campbell, thanks for always digging in to every fine detail, getting excited, and sharing your insider industry knowledge with me. To Derek Harrison, my trusted proof reader– your insights are always on point, and your patience is unmatched. Zannah Mae Matson, I thank you for your critical eye. Cathy and Faust – I can't say thank you enough for all the support throughout this process. To the Society of Beer Drinking Ladies, for the inspiration to cover this topic in the first place. And last but not least – beer. Thank you, beer.

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## 1.0 Introduction

The micro-brewing, or craft brewing industry, is a rapidly emerging section of Ontario's economy and local food system (Agriculture & Agri-Food Canada, 2015; Beer Canada, 2016). Since the late 1980s, 311 breweries have opened shop in Ontario. The growth of the industry is interesting for a number of reasons. The government control of beer and alcohol sales in the province has created a number of challenges for small scale brewers, challenges only now beginning to shift. Historically, the beer industry has been defined by the consolidation of three major industrial scale brewers who control at least 80% of the market. The growing craft sector has pulled local agriculture toward commercial hop production and opened up discussion of grain sourcing and processing. The trend toward local consumption has created a broader dialogue that questions the dominant corporate and government controlled framework of beer and alcohol sales in Ontario. The industry's recent growth also appears to, in part, be related to the broader local food movement, with a developing terroir of Ontario beer.

This paper offers an interdisciplinary discussion on the emerging industry. I relied on three major lenses to offer a current assessment of the industry and the experience a brewing entrepreneur has in Ontario at present. First, I understand the craft brewing industry within the framework of the local food network in Ontario. It is a network of small to medium enterprises (SMEs) that have formed a cluster. I agree with Feenstra's (1997) definition of a local food economy as a self-sustaining network of closely knit food producers and consumers, stimulating local economic activity. The recent surge in activity in the craft beer industry echoes this concept. A local palate for craft beer is developing, as well as an affinity for the community food system that created it. As beer is an alcoholic



beverage, it is not an essential food item, though it reflects many of the same principles as those applied by local food processors.

Second, this paper places the SME network of the micro-brewing industry within the framework of the green economy (Victor, P; Jackson, T, 2013), which sees SMEs having a pivotal role. “These organizations typically have strong ties to their local environment and community. SME’s are well placed to disseminate knowledge and innovative practices whilst delivering environmental and economic resilience,” (Green Economy Coalition, 2012; Eurobarometer, 2012). Further, it seeks to understand the role of SMEs such as these in contributing to a low-growth or steady-state economy as outlined by Victor (2008). A major principle of this macroeconomic model is to question the value of growth as the sole or primary economic motivator. A key component of the micro-brewing movement has been motivating factors for entrepreneurs aside from company growth, such as passion (Watne; Hakala, 2013), but also a desire to remain small-scaled, independently owned, and highly critical of uncapped firm growth.

Finally, this paper approaches the industry at the individual company level, examining business practices and sustainability therein. This approach is useful in understanding the functional and operational challenges and successes food SMEs have in carrying out their place within the green economy and local food system. I endeavoured to understand the challenges and successes regarding financing, operations, distribution and marketing of these SMEs within the odd existing political framework in the province.

In understanding the business challenges and successes of micro-breweries, it is crucial to understand the policies that dictate what these businesses can and cannot do,

and what challenges have flowed from functioning in the shadow of mega foreign-owned breweries. In some cases, that corporate concentration has been entrenched in brewing policies in Ontario. Thus, this paper will provide discussion on the major regulations affecting craft brewers, what effect those regulations have on day-to-day business practices, and the nature of the business relationships those regulations create. It must be noted that as recently as December 2015, a number of major policy roadblocks have been addressed by the Government of Ontario and so the subject is ripe for future discussion on the impact those new policies will have.

The major questions addressed in this paper are: **what role do SMEs have to play in the local food movement in Ontario; what are their entrepreneurial limitations or strengths under the current system and, by extension, what are their capabilities in integrating sustainability into their business practices?**

### *1.1 The History of Ontario's Beer Industry*

Ontario's beer industry has a long and complicated history. As beer is an alcoholic beverage, brewing companies have been subject to criticism from the temperance movement, are vulnerable to prohibition laws and function at the mercy of liquor control laws. In the early-to-mid-20<sup>th</sup> century, the industrial revolution, pushes for efficiency, globalization and the consolidation of manufacturing affected the beer industry, and by extension the final product as we know it today. At present, segments of the beer industry are changing dramatically and regulatory frameworks are similarly being altered to catch up.

Early breweries in Ontario were small operations that almost exclusively distributed locally. In the early-to-mid-19<sup>th</sup> century, the local brewery located in a small Ontario town was common. Transportation channels for distribution were limited and the majority of production remained artisanal, with most beer styles borrowed from Ireland, England and Scotland, where the majority of the population had recently emigrated from. Near the end of the 19<sup>th</sup> century, major Ontario-based companies (that continue to exist today) such as Labatt, Carling, O’Keefe and Sleeman took control of the market and grew to industrial scale, in step with other manufacturing industries during the industrial revolution. The growth of the industry was slowed immensely by the prohibition era, which came into effect in 1916. It is worth noting that during prohibition, the manufacture of beer was never outlawed outright, in that manufacturers were able to continue to brew for export. This meant that breweries that had certain economies of scale were able to remain afloat. This is primarily how the existing beer companies from the pre-prohibition era were able to persist throughout this period.

In 1927, prohibition was lifted and the Liquor Control Board of Ontario (LCBO) was created, along with the beer distributor Brewers Warehousing Company Ltd., which was a collective effort of the few existing major brewing companies to warehouse and wholesale distribute beer. With the purchase of all brewing retail outlets in 1940 by the newly formed Brewers Retail Inc., the only alcohol sales in Ontario not directly administered by the Province were controlled by the major brewers.

Throughout the mid-20<sup>th</sup> century, the beer industry underwent further consolidation whereby the already large breweries got larger. The industry could be characterized as an oligopoly, that is, in the hands of a small number of very large firms

producing a uniform product. “It was separated by differentiated advertising strategies, much like many other industries that capitalized on scientific management and the “Ford assembly line” strategy focused on efficiency, standardization, and economies of scale. In short, beer brewing is a highly institutionalized field” (Catalfamo; Menna, 2012, pg. 3). Refrigeration made it possible to store and ship beer products over great distances, eliminating the major barriers to centralized mass production (Clemons, Gao, & Hitt, 2006; Tremblay et al, 2005). Many studies on the beer industry in Ontario and Canada have touched on the industrious history of E.P. Taylor and the biggest breweries throughout the 20<sup>th</sup> century: Molson, Labatt’s, Carling and O’Keefe. These breweries existed as large staples from the end of the 19<sup>th</sup> and well into the 20<sup>th</sup> century, with two of the three continuing today. Brewing at a large scale has meant that many business and economic studies of the brewing industry have focused on the benefits of efficient, large scale industrial breweries (Swinnen, 2011; Rohmer, Wilson & Ghourvish, 1998). During this key period, the concept of establishing the lowest price for beer possible was established to decrease “wasteful selling expenses” while increasing sales, volume and taxes for the war effort (McLeod, 2014). These priorities and the aim for this particular definition of economic efficiency resonated in the brewing industry throughout the century.

Styles of beer were affected by the commodification of the beverage. The lager, a particular style of beer that is yellow in colour, fizzy and mild in taste reigned supreme. The style became the standard for industrial brewing, as brewing one style of beer was most efficient for mass production. Further, beer manufacturers could use up to 140 ingredients in the beverage; this meant that adjuncts such as corn or rice could replace more expensive

grains, with tastes so mild that the nuances ceased to matter. By extension, the common beer drinker became accustomed to the basic, often bland-tasting lager as the new normal.

Throughout the '50s, '60s and '70s, major industrial beer manufacturers utilized ubiquitous advertising campaigns to differentiate their product and appeal to the consumer's identity. The mass production and mass advertised nature of the beer industry, along with a lack of literacy regarding different beer styles meant that for new brewers to enter the market with a different product, their chances of survival were slim. Today, the two leading breweries control approximately 85% of Canadian-made beer sold domestically (Labatt Brewing, owned by Anheuser-Bush InBev SS, Molson Coors Brewing Co.). The third largest brewery controls roughly 6% of the market (Sleeman Breweries Limited, owned by Japan's Sapporo Breweries) while the balance (9%) of domestically-produced beer is supplied by the micro-breweries (Agriculture and Agri-Food Canada, 2010).

"In the late 1970s and early 1980s, North America industry was embattled as stagflation and increased competition, especially from Japan and Germany, squeezed profitability. Product quality had declined, costs were high, and sensitivity to customer requirements was absent. This resulted in declining market power of established manufacturers in almost every sector, and the advent of greater competition globally marked the beginning of new business models that would later evolve into new industries and would contribute to standard of living. As such, it was a perfect time for a new industry to emerge, or, in the case of Ontario's micro-breweries to reemerge several decades later. In Ontario, for the micro-brewery industry to reemerge and expand, it had to redefine itself

by breaking “out of the box” and create new relationships with customers in the rapidly changing marketplace” (Menna; Catalfamo, 2012, pg. 4).

Organic growth for a young microbrewery seemed unlikely prior to the 1980s, but began to enter the realm of entrepreneurial possibility during the 1990s and into the 2000s. Entrepreneurial pioneers began to snowball during these decades. Gradually, as microbreweries experienced success and showed business acumen and economic stability, craft beer began to succeed. As a result, the literature on the craft beer (or microbrewery) movement in Ontario is still in its infancy. Many studies on the microbrewing industry have looked at the United States, New Zealand or Australia, but Ontario’s craft beer movement faces a unique set of challenges unlike any other region.

The Ontario Craft Brewers Association formed in the early 2000s and has lobbied provincial and federal governments for changes to unfair policies that favoured the large foreign-owned brewers. In 2006, the Federal government implemented a tiered taxation system for excise taxes on brewers, and the Ontario government followed suit with the Beer and Wine tax in 2010. In 2004, the Ontario government introduced the Ontario Microbrewery Strategy and has provided funding to small brewing entrepreneurs in various forms ever since. In the 2015 Budget, the Ontario Government introduced the New Beer Framework which addressed a number of structural issues in retail sales and distribution policies.

Currently, there are roughly 300 licensed micro- breweries<sup>1</sup> operating in Ontario, including contract brewers who received manufacturing licenses from the Alcohol and Gaming Commission of Ontario (AGCO).

### *1.2 Terminology: Micro-brewing and Craft Beer*

The terminology ‘craft brewing’ or ‘micro-brewing’ is admittedly fluid. The distinction occurs most in craft beer regions that have similar histories of corporate consolidation and the commodity-lager. “Currently, devotees distinguish between “craft” and “mass” beers. ‘Craft’ connotes both ‘small scale’ and ‘high quality’, with ‘quality’ usually meaning no ‘adjuncts’ (like rice or corn) and no artificial ingredients; but scale and quality are not synonymous... two American beers of craft quality, are produced under contract in large breweries; and every domestic lager in Germany, however large the brewery that produced it, is free of adjuncts and artificial ingredients.” (Swinnen, 2011, p.230)

Conversely, in the 1990’s, the term “premium” was commonly used in beer marketing to distinguish supposed high quality beers from those of lesser quality. The term became so commonly used that it ceases to have any concrete meaning (*ibid.*, pg. 191).

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<sup>1</sup> 41 brewpubs, 52 contract brewers

The Liquor Control Act broadly defines the term “small brewer.” That definition is as follows:

(4) For the purposes of paragraph 10 of subsection (2), a beer manufacturer is a small brewer for a sales year if,

(a) in the preceding production year, the manufacturer’s worldwide production did not exceed 400,000 hectolitres of beer or, if the manufacturer has been manufacturing beer for less than one year, its worldwide production is not expected to exceed 400,000 hectolitres of beer in the year; and

(b) every affiliate that the manufacturer had that manufactured beer in the preceding production year was a small brewer (*Liquor Control Act, R.S.O. 1990, c. L.18*).

This paper will use “micro-brewing” and “craft beer” synonymously. The term “craft” will be understood as a catch-all for the three tenets of craft as described by the Ontario Craft Brewer’s Association (OCB). These tenets are:

**“SMALL** Most Ontario Craft Brewers are small and many are family-owned. The current maximum size of an Ontario Craft Brewer is 400,000 hectolitres of annual worldwide beer production.

**INDEPENDENT** Locally-owned and is not significantly controlled by a beer company who does not qualify as an Ontario Craft Brewer.

**TRADITIONAL** Pledge to brew traditional and innovative beers according to the Ontario Craft Brewers’ Brewing Philosophy. The original Philosophy was signed on April 12, 2006 and was updated in September 2013” (Ontario Craft Brewers, 2015).

It is worth noting that each brewery interviewed for this paper holds membership with the Ontario Craft Brewers Association, and as such each brewer discussed in this paper abides by these standards.



This paper will also use the catch-all “foreign-owned brewers” and “macro brewers” to refer to Molson-Coors, Labatt (AB-Inbev) and Sleemen. I use this term as it easily distinguishes the independent brewers in this paper from these competitors.

### *1.3 The Economics of Craft Beer: in the Literature*

Agriculture and Agri-Food Canada’s description of the Canadian beer industry is as follows:

“The Canadian industry has rationalized considerably through mergers, acquisitions and new microbrewery start-ups, and continues to do so. Over the years, the industry structure has changed as the number of conventional plants has decreased while the number of micro-breweries has increased considerably. As of 2009, both conventional and micro-brewery plants operate in all ten provinces, and one is located in the Yukon.” (Agriculture and Agri-Food Canada).

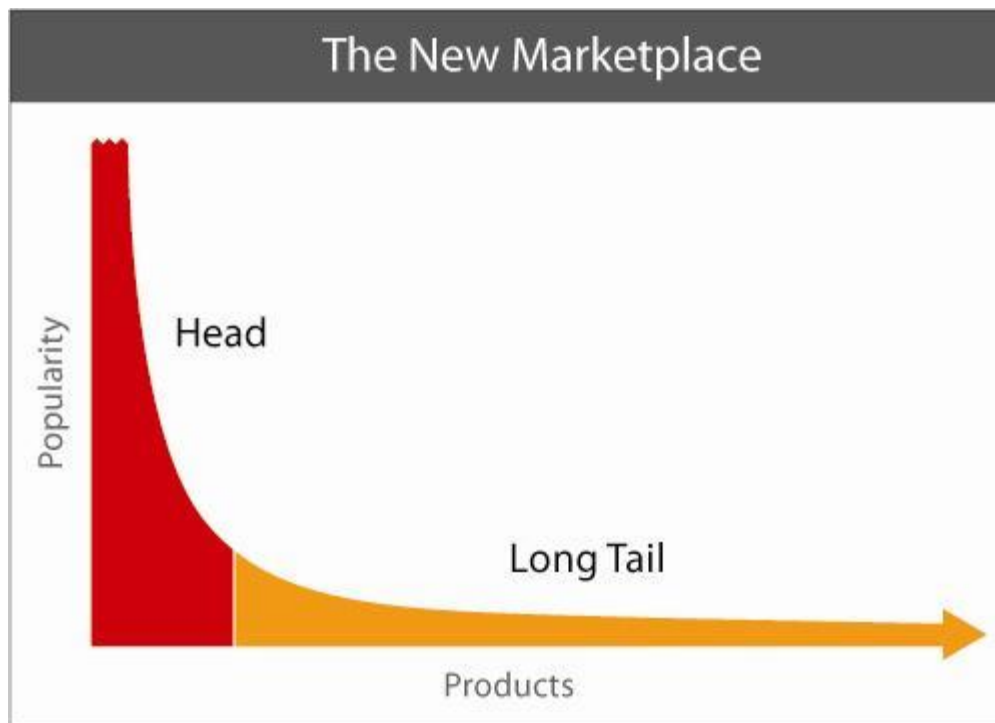
The growth of the craft beer industry is not unique to Ontario: there are similar regions whose growth of craft brewing parallels Ontario’s recent growth. In the existing and emergent literature on craft beer industries, the concepts of Resource Partitioning Theory and the Long Tail theory are often used to analyze the growth of niche industry. The industry’s growth in various parts of the world is interesting because many economists such as Porter (1980) did not foresee it, “in fact, they predicted the opposite—a continued contraction in firms... [Porter] wrote that “in the brewing industry, product differentiation is coupled with economies of scale in production, marketing and distribution to create high barriers” (Carroll; Swaminathan, 2000).

Resource partitioning theory essentially acknowledges craft brewers as specialists within their field, emerging from a need for specialization in a commodified market.

“Resource-partitioning theory explains the rise of late-stage specialist segments within an industry as an (unexpected) outcome of the consolidation occurring among large generalist organizations as they compete for the largest consumer resource bases of the mass market” (*ibid.*).

In this case, large breweries such as Molson-Coors, Labatt or Sleeman can be understood as “generalist organizations,” in that they are meeting a general need for beer in the market, while microbreweries can be understood as “specialist organizations,” that choose narrow, homogenous targets. Craft brewers, then, are competing with the large, foreign-owned brewers indirectly by offering a differentiated product.

Similarly, the Long Tail theory (Anderson, 2009) can help explain the business strategy of successful niche products. Essentially the theory sees increased choice leading consumers to seek out specialized products, as opposed to the one variety of a mass-produced product. The consumer’s ability to seek out and demand more unique, differentiated products has been benefitted by new media channels such as the internet, which have made it profitable for companies to create products that market to these niches. The theory is described as “large quantity of unique items, small quantities sold of each” versus “fewer, popular items in large quantities” (*ibid.*).



Source: <[www.longtail.com](http://www.longtail.com)>

## 2.0 Current Frameworks

### *2.1 Regulation*

Both the federal and provincial governments regulate and tax the production and sale of beer. The Government of Canada regulates the production, quality, labelling, advertising and international trade of beer and imposes commodity, consumption and excise taxes. The Government of Ontario regulates the production, distribution, pricing and marketing and imposes licence fees and commodity taxes on the production and sale of beer.

In Ontario, social policy objectives have had a significant effect on the direction of policies adopted by alcoholic beverage regulators, with the Government of Ontario having a high degree of involvement, particularly in the regulation of pricing, sale and distribution. The primary distribution channels for breweries in Ontario are the LCBO, The Beer Store (TBS), brewery-owned on-site retail stores, bars and restaurants and, as of November 2015, licensed grocery stores. Provincial and federal taxes, fees and levies account for approximately 50% of the retail price of beer. The Alcohol and Gaming Commission of Ontario (“AGCO”) also enforces a Minimum Retail Price (MRP) for beer and requires each product to be sold at a uniform price across all retail outlets.

The sale of beer in Ontario is regulated through the Liquor License Act and the Liquor Control Act. The Liquor License Act enforces certain licensing requirements for breweries and requires breweries to pay fees to the Government of Ontario based on the volume of beer shipped for sale and distribution. The Liquor Control Act establishes the LCBO as the regulator for the sale of liquor in Ontario. With the introduction of the

harmonized sales tax (“HST”) in Ontario, the total sales tax on beer dropped from 17% to 4%, and a Beer and Wine tax administered by the Ministry of Revenue was introduced to make up for the lost revenue.

## *2.2 Sales Channels*

For the purposes of this paper it is important to understand the sales channels available to small brewers. Alcohol sales in Ontario are highly regulated, and as such, complicated for the entrepreneur navigating those regulations. Sales are arguably the most regulated component of a craft brewer’s business operations. Craft brewers have five major sales channels available to them, and each has its own particular nuances prescribed in legislation that often affect what sales relationships look like to the brewer. The sales channels a small brewer opts to build their business on can reveal much about the nature of Ontario’s liquor control policies and how difficult or easy those regulations are to follow. Sales channels for small brewers in Ontario have also been a point of political controversy for a number of reasons. Ontario’s alcohol retail sales have historically been controlled by the LCBO, a Crown monopoly, and The Beer Store (TBS), which is owned by the three largest foreign-owned beer manufacturers in Canada and holds a monopoly on selling beer in large formats such as twelve and twenty-four packs. TBS, or Brewers Retail Inc., has had an ongoing relationship with the LCBO since the end of prohibition in the 1920s (Genosko, 2012), with this preferential treatment continuing in the form of written agreements as recently as 2000 (BRI; LCBO, 2000). The small brewers interviewed for this paper, unsurprisingly, noted complicated relationships with both firms, as will be discussed in the

analysis section of this paper. Aside from these two major retail channels, manufacturers are permitted to sell product where it was manufactured and their prices must match by law what those products are listed for in the LCBO. Brewers also have the option of selling their beer directly through licensees – that is, at bars or restaurants that are licenced to serve alcohol.

On December 15, 2015, the Provincial Government permitted beer sales in “New Private Retail Outlets,” i.e. grocery stores. At the time of the majority of interviews for this paper, grocery store sales had not yet been launched. For the few interviews that occurred after the announcement and subsequent launch, there was some rich commentary on what that sales relationship may look like in the future.

### 3.0 Methods

I utilized case study analysis (Yin, 1984) on four brewery cases. I interviewed four brewery owners and in some cases a number of their staff utilizing semi-structured interview questions. In these interviews I gleaned their start-up stories, what challenges and points of ease existed during that process, what present challenges and successes they report and their perceptions of the industry at large. The interview guide can be found in the appendix.

In choosing breweries to interview for this paper, I attempted to represent differing scales of operations and lifespans. In including two older breweries that had existed since the mid-to-late-1990s, I was able to capture some of the progression of the craft brewing movement up to now. Examining four breweries of different scales – which is commonly understood by yearly hectolitre output - I was able to glean information on the scaling process for a craft brewer, as well as how certain policy frameworks affect smaller and larger SMEs. Including one start-up brewer, Block Three<sup>2</sup>, I was able to gather information on what market entry for a brewing entrepreneur looks like at present.

To supplement information and provide added nuance, I included one interview from an industry worker, Erica Campbell, who has worked in sales at three separate Ontario craft breweries. Her insights on her relationship with The Beer Store, the LCBO, licensees and her perspective on her strategies to navigate grocery store sales were invaluable to gaining insight on the nature of SMEs' relationships to large companies.

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<sup>2</sup> It is worth noting that I had hoped to include one more start-up brewer, though it was difficult to find research subjects at this scale and age of business that were willing to participate. I speculate that this is due to the hectic nature of running a start-up business.

This paper utilizes an interdisciplinary approach to understand Ontario's burgeoning craft beer industry. Many of these entrepreneurs approach their business practices with a sense of ethics to counter the market concentration and disconnectedness and corporate bullying of the foreign-owned breweries, and as such there is room for discussion of the interworkings of sustainability and local economic prosperity. How SMEs work things like sustainability and social consciousness into their business models will be explored and discussed.

Similarly, the craft beer industry in Ontario represents a growing local agri-food industry network, so bringing principles of food studies into this paper was pertinent. The growth of the industry has created a demand for many resources, among them hops and grains, for which Ontario agricultural production lags. Understanding this industry as part of a larger network of suppliers, processors, producers and consumers reveals much about the cultivation of a thriving local economy.

Many craft brewers hold the view that uncapped growth is neither the means nor the ends of success. This sentiment is in keeping with the low growth economic principles of Victor (2008). Perhaps as a result of attempting to eke out success in the shadow of the foreign-owned brewers that control 80% of the Canadian market, these entrepreneurs have a heightened awareness of the flaws inherent in growing their businesses too big and are seeing the local economic benefits that vibrant small businesses can contribute to.

No discussion of an alcohol in Ontario can exist without addressing the tricky, convoluted and challenging political and legislative landscape craft brewing entrepreneurs must function within. To look at industry success factors and to understand the growth of



the network, this paper must necessarily explore briefly the policies that most affect craft brewing entrepreneurs.

## 4.0 CASE STUDY: Beau's All Natural Brewing Co.



Beau's All Natural Brewing Co. has been in existence since July 2006. It is located in Vankleek Hill, Ontario, a small town an hour east of Ottawa and an hour west of the Quebec border. It currently operates at 40,000 hectolitres per year and employs 140, 91.6% full time and 8.4% part-time. Endearingly referred to as Beau's, this company brands itself as an All Natural company as it adheres to Pro-Cert Organic Systems Ltd. standards, using only certified organic ingredients. They market their product as a niche high-end premium, building on local palate. Beau's distributes all over the Province of Ontario, and has broken into the Quebec and Upstate New York markets.

### *4.1 The Story*

Beau's company narrative is an endearing one, founded as a father and son family company in the town that President Steve Beachesne grew up in. In 2004, Steve was living in Toronto doing business planning for the government during the day and running a record label at night called Go Go Go Records. His father was running a textile business in the building where Beau's is currently housed until the textile business moved offshore. Mr.

Beauchesne Sr. went to visit Steve in Toronto, bereft of his profitable business. Steve was an avid homebrewer and had been following the slow build of the craft beer movement. As many craft breweries' start up stories begin, the two had the idea over a couple of beers, and over the following two years took steps to set their business plan in motion. At the time, Eastern Ontario did not have a notable craft brewery, so the father and son entrepreneurs endeavoured to fill the void.

#### *4.2 Challenges: "Anything that is easy wouldn't be fun."*

In the beginning stages, securing a business loan from traditional banks was a challenge as a craft brewery seemed high-risk and there was little, if any, evidence of successful craft breweries. Business Development Canada, Canada's most progressive lender, did not believe a craft brewery could be successful at the time. The bank insisted on a feasibility study, that would convince a consultant that their brewery had a high chance of succeeding. Despite convincing plenty of characters within the banking system that they had a feasible business model, they ran into a number of roadblocks before they could secure funding from their local bank, though in the end their start up loan was significantly smaller than they had expected. Beau's experience in the early 2000s reveals the hesitancy of financial institutions to support start-up businesses such as craft breweries.

Steve believes that receiving an initial loan of less than half of what they had expected was, in fact, helpful in that it "built a sense of frugality into the business model". They were forced to be resourceful and do more with less. It instilled a sense of urgency and importance in making the business profitable.

Their biggest challenge: keeping up with the growth rate and growing responsibly. The growth rate at Beau's has never been less than 35% per year (with last year's growth at 47%), and as such there are big decisions to make at the end of each fiscal year. This level of organic growth has meant that there is a built-in process of examining where to reinvest in the company and identify what needs arise as the company grows. Candidly, this is an ideal problem for a new business to have.

Steve pointed out very quickly that with regards to sales channels in Ontario, "there are challenges that cannot be understated," but he pressed that the company's biggest challenge had always been keeping up with growth from a financing perspective.

### *4.3 Success Factors*

Beau's was able to take advantage of a wide open market landscape. Prior to Beau's, the Ottawa area had had a number of notable craft brewery failures. Hart Brewery, which had existed from 1991 to 2001, had shut its doors for a number of reasons. Steve speculated that this may have been because "it was before its time." It was noted that prior to the mid-2000s, Ottawa was considered a dead zone for craft beer, with many Toronto-based breweries uninterested in exploring the market in that region due to expected low sales. Beau's was in a position to be most people's first craft beer experience in the area. This pioneering of the market has generated a brand loyalty and recognisability that has worked to the company's advantage.

#### 4.4 Marketing Strategy

The frugality of Beau's early business operations allowed for an unexpected advantage. The company does not engage in traditional advertising, as it presented too high an expense during the company's modest beginnings. Beau's has utilized a strictly in-house marketing team. The cost savings from not paying for advertising, by their account, allowed the Beauchesnes to allocate more resources toward quality ingredients and producing the highest quality product with the acknowledgement that "if your beer isn't good, it doesn't matter what you spend on advertising." (Interview, Steve Beauchesne, Nov. 11, 2015).

The advantage presented itself when their product gained popularity through word of mouth and direct relationships. "[Not having advertising] meant that you heard our name through the friend that you trusted or sommelier at the restaurant who would talk you into trying this great beer from Vankleek Hill." (*ibid.*) This cultivated a trust in the product and added to a general culture of authenticity: the relationship with the product would come before the brand recognition.

Beau's also recognizes that the local food movement has aided the company's success. Beau's sales in its first few years were focused on licensee keg sales in Ottawa. The emerging prominence of independent, chef-led restaurants and bars since the mid 2000s meant that Beau's earliest sales representatives were able to form direct relationships with a substantial number of bar and restaurant owners to build momentum around the product and company locally.

A successful marketing tactic was to partner with restaurants who were early adopters of the local food movement and craft beer. While the macro breweries continue to

hold the majority of market share and their product continues to monopolize tap space at large chain restaurants and bars, Beau's found that there were an increasing number of locally-focused bars that were eager to serve craft and partner with them over the macro breweries. This marketing channel was also practical for the company as taking on lower volume accounts meant that the company could keep up with the demand it was creating in its early stages.

As the first mover in the Ottawa area, Beauchesne had witnessed the gradual acceptance of the craft market first hand: once the independent licensee accounts began to gain traction and there was a demand for local beer, larger accounts began to take note in a second wave of adopters of the product.

#### *4.5 Organic Certification & Ethical Sourcing*

Beau's is certified under Pro-Cert Organic Systems Ltd. Steve Beauchesne explained that when the company opened they were unsure of whether organic certification was worth the financial investment as it would peg operating costs at 40% higher than any other brewery. Branding themselves as "All Natural," the company chose to certify with Pro-Cert after hearing skepticism from consumers that they were in fact organic and using natural ingredients, and that without the proper certification, the "All Natural" component of the company's branding was greenwashing. It seems as though organic certification has had a positive impact on the growth and success of Beau's.

#### 4.6 Sustainability

Sustainability was a continuous discussion throughout this case study. To his approach to sustainable business practice, Steve expressed “I feel like I keep trying to do the right thing the right way ... and make mindful decisions. Growth seems to be what we are rewarded with for doing the right thing ... it [sustainability in business] is about making mindful decisions” (*ibid.*).

Beau’s organic certification has caused the company to place special emphasis on ensuring quality from its suppliers. The company employs at least two staff to oversee Organic Compliance and ensure that orders of grain and ingredients received are up to the company’s rigorous standards as well as ensuring all documentation is up to date for regular audits from Pro Cert. These staff noted in interviews that stringent documentation and auditing is not particularly difficult to maintain, and has only benefitted the brewery and its processes.

The company has a sense of itself as a major local economic driver, with a responsibility to act as leader in its community. This is evident in its purchasing practices. The company’s organic supply requirements have meant that they must necessarily acquire ingredients from Europe, as Ontario lacks the agricultural network of organic hop and barley growers to keep up with their demand. There are secondary geographical considerations when purchasing barley and hops as both of these ingredients require some level of processing prior to reaching the brewery. Barley must be malted, and Beau’s is limited by the fact that the closest certified organic malting facility is located in Washington State. “To purchase Canadian grain from the prairies and have it shipped to the West Coast

and then to Eastern Ontario is much less efficient than ordering grain from Europe which is shipped by boat and delivered to the port in Montreal,” (*ibid.*) one hour away. Further, the companies that distribute Canadian malt also buy grain from the Midwest states, so it is difficult for the brewery to guarantee that the malt is in fact Canadian<sup>3</sup>.

Similar considerations exist for hops. While there is an increasing number of local hop farms, the crop should ideally be dried and pelletized prior to use to be of value to the company. Purchasing manager Jeff McCauley noted that “90% of brewers using Ontario hops are using them in wet hopped beers, which are released as a seasonal Harvest Ale to take advantage of the harvest in the autumn and the marketing power of being able to say that beer was made with 100% local hops,” (Interview, Jeff McCauley, December 9, 2015). However, hops are most valuable to a brewing company when they are pelletized, dried and stored and can be used at other points in the year. “I work with hop farmers that can actually get them pelletized at a certified organic processor, and that’s a challenge,” (*ibid.*). Both Beauchesne and Purchasing Manager Jeff McCauley noted that the company had “worked really hard” with the local hop industry. This implies that Beau’s has supported new Ontario hop farmers in recent years to start their hop growing business, having created the demand locally and committing to buying as much local supply as they can. The narrative of the Old 4<sup>th</sup> Hop Yard reveals the paralleled entrepreneurial partnerships between the emergent hop industry and craft breweries. Old 4<sup>th</sup> Hop Yard is one of Beau’s suppliers, based locally in Williamstown, Ontario. They had decided to start their hop farm after a tour of the Beau’s brewery and worked in conjunction with Beau’s All Natural, who

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<sup>3</sup> In discussion with Steve Beauchesne over sourcing local, he made the assumption that when I referred to sourcing local I necessarily meant Canadian.



signed a five-year contract with them, committing to buying all of their product over that period. However, despite this hop farm neighbouring the brewery, the only certified organic hop processor in Ontario, Big Head Hops, is located in Meaford, a six-and-a-half-hour drive away. There are plans for hop growers to open a processing facility locally, which Beau's has stated it will commit to supporting, though the timeline on that project was unclear. Beau's is also working closely with its partner hop producers and neighbouring farms to support and promote a network of growers to supply the brewery. At present, the Ontario Hop Grower's Association has forty-two members, and only three of those are at a commercial size, which is minimum eight to ten acres. Industry lore states that that eastern Ontario was "a major hop growing region 80-90 years ago," which McCauley noted in our discussion.<sup>4</sup> The two major factors leading to the hop grower's downfall were crop disease – a challenge that still exists for the hop crops and makes organic growing particularly difficult – and prohibition in the mid-20<sup>th</sup> century. McCauley notes that for the production of their local Ontario hops, the brewery can go through that volume in a day. It would be worthwhile, for the sake of future studies, to provide an in-depth look into future of the hop growing industry. While Ontario can grow a number of the major hop varieties that are in demand, there are noticeable taste differentiations between growing regions – which is to be expected and has not proven a significant problem yet. McCauley also discussed the future of Ontario's own specialty hops, as innovation in that regard is in its infancy.

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<sup>4</sup> The idea that Ontario was a major hop growing region in the early 20<sup>th</sup> Century is, in my personal experience, passed around commonly in the craft beer industry. While it would have proven too much for this paper, I would be interested to look to any archived documents to see what was being grown in Eastern Ontario at the time to prove whether this is true or not.

Beauchesne is aware of the marketing value of local purchasing. Being able to state that they utilize 20% local hops in the last year seemed to resonate with customers, and as the company raises its production each year, the local hop farm suppliers cannot keep up which lessen the percentage of local hops Beau's can say they are using.

#### *4.7 Scaling Up*

Beau's has experienced a minimum of 35% growth per year since its inception. Each year, Beauchesne explained, the company adjusted itself accordingly and reinvested those profits in the growth of the business. The company has a capital planning strategy and intentions to expand as profit and demand allow. Beauchesne states that they have experienced such steady growth that as president and founder of the company, he has been generally satisfied with the company's financial resources and its ability to keep up with its equipment and operational needs in a timely manner.

Staff in the Quality Assurance department noted that the scaling of the business has been interesting from a human resources perspective. The Organic Compliance Officer, who has worked for the brewery since its earliest stages as a driver and then shifted roles once the brewery expanded in 2011, noted that with expansion came the process of converting "tribal knowledge" of the brewery – that is, the basic operational practices and company information that the earliest employees followed and casually transmitted between them – to documented, archived and formalized practices. A number of employees at the company remember operating as a staff of fifteen, a stark contrast to the workforce of one hundred and thirty today. A number of discussions were had regarding the shift from the small

brewery where one person might be required to act as manager, brewer, purchaser and salesperson in order to get the company off the ground, and the subsequent transition to formalized and specialized roles.

#### *4.8 Company Culture, Employee Satisfaction*

All employees interviewed at Beau's All Natural reported satisfaction with their workplace and compensation for the role they performed there. All employees expressed excitement at working at the company, and possessed a deeper feeling of connection and purpose in contributing to the craft beer industry. Of employees I spoke with, a number of them had gladly relocated to work for Beau's and were loyal customers prior to their employment there. Beau's describes its company culture in its posted job descriptions as follows:

"Beau's All Natural Brewing is a close-knit, family-and-friends company. We take collective pride in creating unique, wonderful and organic craft beer, conceived with honest consideration for the environment and our local communities, and delivered with a sense of friendly relationship. A job with Beau's All Natural means joining a new family – including all the family outings, eye-rolling humour, and wacky siblings you can handle. We have an assertive company culture of camaraderie, strong leadership, ethics, innovation, passion, and genuine enthusiasm for what we do. Life moves pretty fast at Beau's All Natural. We have names, not titles. We brew using equal parts art and science. And we always have time for our friends!" (Beau's All Natural Brewing Co., 2016).

One employee interviewed had relocated to work for Beau's in its early stages and despite educational credentials that qualified him for more senior tasks, took on the role of company driver until 2011 when the company was able to utilize his specialized skillset in the Organic Compliance and Quality Assurance departments. This commitment suggests a high level of company morale, a sense of belonging and a deep sense of purpose within the organization.

#### *4.9 Independence, Ownership & Company Structure*

Beauchesne readily spoke to the value of remaining independent within the corporately concentrated landscape of the Ontario beer industry. He feels that his company is and has been able to grow steadily and responsibly throughout its existence without private investment or relinquishing any ownership. As a member of the Ontario Craft Brewer's Association, Beau's adheres to one of the three major tenets of Craft, of which one is to remain independently owned. The Beauchesne family and the company at large are deeply committed to the company's integrity and feel that allowing for any outside investment or allowing the company to go public would compromise what makes Beau's the brewery that it is.

## 5.0 CASE STUDY: Church-Key Brewing



Source: [churchkeybrewing.com](http://churchkeybrewing.com)

Church-Key Brewing is a sole proprietorship that has been in operation since 2000 located in Campbellford, Ontario. Owner John Graham employs 12 between his brewery and community pub, two businesses he operates separately, but in practice there is much fluidity between the two. The brewery is located in a repurposed United Church building operating at a steady two thousand hectolitres. The company distributes from Cornwall to Windsor along the main corridor with some distribution north as far as Huntsville in the summer. Church-Key sells through various licensees throughout Ontario, a number of LCBOs and The Beer Store. Primarily, Church-Key is known for its innovative beer styles and reliably high quality product.

### *5.1 The Story*

Church-Key identifies, from the time it opened, as craft brewery number eleven in Ontario. A small number had opened and then closed in the province before 1999, but at the time of the brewery's opening, there were ten others in operation. John Graham had been a brewer at Amsterdam in Toronto for a number of years until he decided he wanted to open his own small scale, locally focused brewery where he could remain small and

manage relatively contained operations. However, this humble vision was made difficult by particularly prohibitive policies at the time as well as a limited access to basic resources.

## *5.2 Start-Up Challenges*

Prior to 2006, “you were paying \$30 a hectolitre” (Interview, John Graham, December 15, 2015) in excise taxes which was a particular strain on the small business Graham had created. Once the federal excise taxation system became tiered, Church-Key was able to pay ten percent of that rate since the brewery operates at the smallest tier. This was the first and most notable challenge Graham cited.

At the time, there were a number of infrastructure challenges that were unavoidable. Gilbertson and Page (now Brewer’s Supply Group Canada), the grain supplier that the majority of new breweries purchase grain from, did not yet exist at the capacity it does now. To acquire malt, Graham had to buy from Canada Malting, shipped from Thunder Bay, with the only stock available to a small brewer being “the Molson/Labatt rejects...” in that it was the leftover grain not selected by the foreign owned breweries. “You had to go to where the majors were buying their stuff” (*ibid.*).

Graham also noted that acquiring financing was exceedingly difficult at the time. Banks were particularly skeptical of the brewing business and would not discuss giving Graham a loan to start the brewery. The only financing option available was a Government Guaranteed loan for \$250,000, with a 3% insurance paid on it. This meant that Graham paid \$7,500 in insurance and a \$500 application fee to borrow at 7% interest. Anecdotally, Graham also noted that he has had to liquidate an RRSP, sell his house and take out extra

debt to keep the brewery afloat through the years. The church building is owned in full by John Graham, bought for \$69,000 in 1999. He reported a \$500,000 start-up.

Graham is aware that these financial struggles were of the time, and noted that there are a number of financing options available to the brewing entrepreneur now, observing that banks are eager to lend to breweries now as they are high cash flow businesses. There are also a number of Ontario Government grants available to breweries through OMAFRA and Ontario Economic Development that have taken effect since 2011, though he notes that “they tend to favour companies aiming to be bigger than us” (*ibid.*). Graham’s preference to remain small runs contrary to the economic growth goals of these grants and has placed Church-Key under the radar in a number of regards.

### 5.3 Successes

Church-Key’s success has stemmed from staying true to its initial philosophies and its intended size. John Graham’s intentions in starting the business were to remain small, predicting what capacity he could handle while achieving a work life balance. He also feels very strongly against the notion of growth as a company’s main metric to success. Through remaining small and a sole proprietorship, he has been able to remain flexible and hold himself accountable. “If Molson and Labatt wanted to take us all [craft brewers] out next year, they could buy all of the barley in the world if they wanted to. If that happened, I’d

just start making Gruit Ales<sup>5</sup>" (*ibid.*). As a small company, Church-Key can remain flexible in the face of broad industry changes.

#### *5.4 Sustainability*

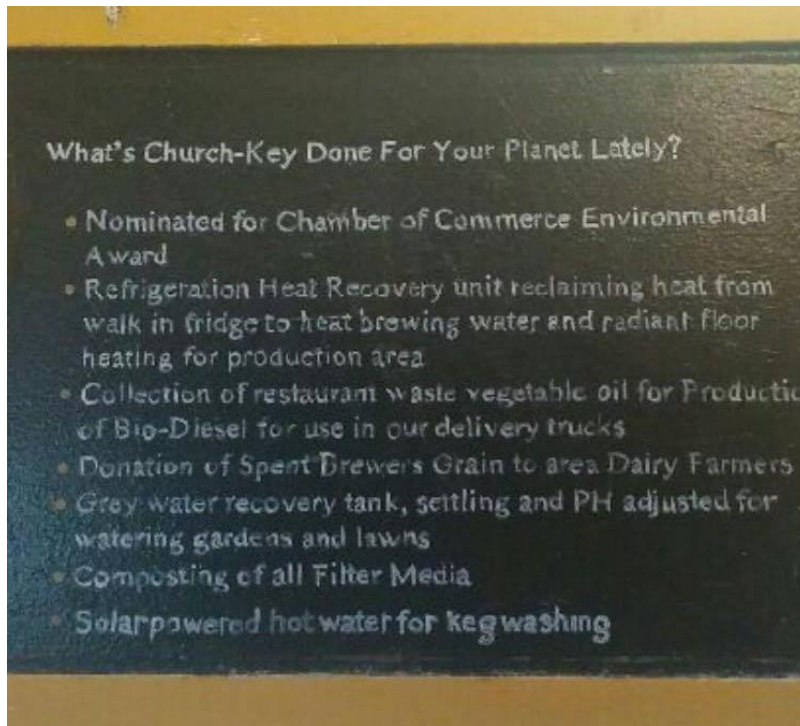
John Graham has championed sustainability in the Campbellford area for a number of years, and these practices have been entrenched in Church-Key's business practice at different times. In 2006, Graham ran in the riding as the federal Green Party candidate. The year prior, Graham and his employees at Church-Key made their own Bio-Diesel for their delivery trucks using restaurant waste vegetable oil on site at the brewery. They were forced to stop this practice as their insurance company threatened to cancel the brewery policy.

Church-Key was an early adopter of Bullfrog Power, a popular alternative green energy provider, though it was found to be too expensive to maintain. Church-Key staff are avid composters and recyclers, and the walk in fridges have heat recovery units which reclaim heat to be utilized in heating brewing water. Graham often finds inventive opportunities to make the brewery systems more sustainable, and he attributes the ease of application of these practices to the contained size of the brewery.

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<sup>5</sup> A gruit ale is a beer that is made using herb mixtures instead of the traditional hops and barley





Source: Church-Key Brewing website (<[www.churchkeybrewing.com](http://www.churchkeybrewing.com)>)

John Graham sources ingredients as locally as possible within cost effectiveness, especially when easily available. When asked about going organic, he explained that he would never want to be as it is less cost efficient, the availability of quality ingredients would decrease and he feels that it would be the “environmentally less responsible thing to do,” (*ibid.*) based on distance ingredients would have to travel to reach him and inconsistent sterilization requirements for breweries.<sup>6</sup>

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<sup>6</sup> Graham discussed that under organic compliance regulations, brewers need to sterilize equipment with caustic soda – a corrosive chemical that is dangerous to use and would then go down the drain – which he feels goes against environmental practices.

### *5.5 Perspectives on the Industry*

Graham attributes the growth of the industry to the local food movement, which he sees as having been influenced by information sharing and social media. The availability of information on their food and beverage products, he argues, has allowed consumers choice that they did not have when only big breweries had access to advertising on a broad scale. Graham remembers a time when brewers would subscribe to one publication that was released six times a year to keep up to date with the brewing industry, which is now made obsolete by the various communication channels that currently exist.

As for the industry's weakness, Graham's perspective is that the big breweries are getting bigger and acquiring craft breweries at an alarming rate. To a brewery the size of Church-Key, particularly A. B. Inbev is seen as a bully corporation, and the acquisition of Mill Street Brewery in Toronto by this conglomerate was condemned.

## 6.0 CASE STUDY: Muskoka Brewery



Source: [Muskokabrewery.com](http://Muskokabrewery.com)

Muskoka Brewery has existed since 1995 and operates in Bracebridge, Ontario at 45,000 hectolitres per year and employs 110 at roughly 80% full time, and 20% part-time.

Muskoka owes its place in the market to brand recognition by the Toronto cottaging crowd. Gary McMullen, President of Muskoka Brewery operated the brewery as a labour of love for its first ten years since Federal Excise tax on brewers and sales channel limitations made growth difficult. Muskoka distributes throughout Ontario, a number of North Eastern states and until recently Western Canada. Muskoka is speculated to be the second largest Craft Brewery in Ontario.

### *6.1 The Story*

The idea for Muskoka Brewery was started by partners Gary McMullen and Kirk Evans in the mid-1990s. The pair had taken note of the number of small scale breweries establishing themselves in Ontario, as well as being avid homebrewers themselves. Prior to founding the brewery, President Gary McMullen was an aerospace engineer in Ottawa working for the military. The progression of breweries that were Muskoka's predecessors,

such as Creemore, Upper Canada and Brick, were fascinating to him. McMullen left the military in 1994, after which he approached Kirk Evans with his entrepreneurial idea. Muskoka Cottage Brewery opened its doors on June 15<sup>th</sup> 1996. Muskoka Brewery is considered to be of the second wave of craft breweries.

The brewery gradually solidified its place within the Bracebridge community and its cottage owners, utilizing localized marketing imagery that was recognizable to cottage goers in the region.

Tragically, partner Kirk Evans passed away in January 1997 after a fatal car accident. This major upset occurring so soon after the brewery had opened its doors is one of the major moments McMullen references in describing the passion, integrity and perseverance he feels his company espouses.

### *6.2 Start-Up Challenges: “You worked really hard and at the end of the day there was no money”*

A major challenge for McMullen in starting Muskoka Brewery was low consumer acceptance. The market concentration that the larger breweries held at the time, the lack of diversity of beer products available and the effective advertising campaigns of the major breweries throughout the previous decades had convinced consumers that “beer was a 5% yellow fizzy beverage.” Muskoka Brewery entered the market at a moment when the product was understood as a commodity and consumers had limited access to nor any literacy for different beer styles.

McMullen explained that this issue was exacerbated by the brewery's location in Bracebridge, Ontario, a particularly small, northern town. Bracebridge at the time was no exception to the common lack of access to a diversity of food items (Food Secure Canada, 2015) and adjusted to the change in products gradually, largely through the strong sales and educational efforts of representatives from the brewery. The core target demographic was Toronto, where there was a larger market to sell to, and that extended to those that owned cottages in the area.

A particular challenge at the time was selling product through licenced establishments, as locals who ran those establishments and their customers who did not understand the product nor Muskoka's mission. Through perseverance, Muskoka representatives insisted they were working toward the rebirth of an industry.

Muskoka Brewery has faced many of the pivotal policy challenges unique to brewers head-on throughout its existence. Until 2001, excise duty on all beer produced in Canada was taxed at the same rate regardless of the output of the brewery. The implications were that Muskoka Cottage Brewery in its start up phase was paying equal excise duty rates as giants Molson and Labatt. "The taxes we were paying accounted for 21% of net revenue – it was more than our payroll taxes by far." (Interview, Gary McMullen, November 23, 2015). By 2001, through dedicated lobbying that McMullen participated in on behalf of Muskoka Brewery, the Federal Excuse Duty switched to a tiered system:

"For beer produced in Canada, it was announced that new reduced rates of excise duty were to be tiered according to a licensed brewer's beer production in a calendar year,

and would not apply to licensed brewers whose annual beer production is greater than 300,000 hectolitres,” (Canada Revenue Agency, 2006).

That year, Muskoka Brewery went from paying the full excise rate – which would have been anywhere between \$25-\$30 per hectolitre (Canada Revenue Agency, 2006) to a tenth of that. Two years later, Provincial excise duties were similarly changed to reflect smaller scaled companies. Those changes in taxation were fundamental to the success of a small scale brewery, which Muskoka observed first hand. “Those two changes overnight changed what a profit and loss statement would look like for us,” (Interview, Gary McMullen, November 23, 2015).

With this gradual shift throughout the 2000s as taxation policies began to take their full effect, the craft beer industry began attracting investors who were seeing from the outside that brewing could be profitable.

### *6.3 Current Challenges*

Gary McMullen readily stated that it was a “great public policy success” that they were able to make such great strides lobbying the Provincial and Federal governments for scaled taxation. However, they continue to be hampered by the retail systems for beer in Ontario. He acknowledged that there is a fine line between a blown open retail system and one that promotes competition, and at present they do find they run into a number of challenges. They feel that another breakout is required to deregulate the industry a bit more than it currently is.

The new legislation that allows beer to be sold in grocery stores continues to represent heavy regulation and, by McMullen's interpretation, is still heavily controlled by big foreign breweries. McMullen explained that "the big breweries are in talks with the Liberal government to control at least 75% of that retail space over a 10-year framework."<sup>7</sup> He notes that it's "never a good day when you have to sell through your competitors."

Managing cost side challenges can also be difficult in terms of ordering resources like hops that are "technically commodities." They will contract hops out 3-4 years in advance – which is investing in futures that, because it is an agricultural commodity<sup>8</sup>, cannot be guaranteed. As a result, there is some risk associated with that end of the business.

Further, since the recent New West Partnership between British Columbia, Alberta and Saskatchewan, which gives preferential taxation to local brewers in the region, Muskoka Brewery offered a public statement condemning this policy move and pulled out of those Western Provinces. The company feels that the policy promotes divisiveness among Canadian craft breweries and speculate that the move was in part influenced by the foreign owned breweries. Muskoka believes in developing the Canadian craft network, thus their sense of local appears to be Canada wide.

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<sup>7</sup> It is very possible that this piece of insider knowledge that McMullen has access to is correct, though I am unable to confirm if those negotiations are occurring.

<sup>8</sup> Gary McMullen's words, though hops could be too small of a production crop to technically qualify as a commodity.

## 6.4 Successes

Muskoka Brewery owes its success to a number of factors, the first of which being its resolve to never quit. As McMullen stated, original business partner Kirk's passing within a year of opening the brewery was a pivotal moment when the Brewery could have just as easily closed operations. "The first few years were a real challenge, but our can-do attitude and finding a way to get the job done, no matter what, has been integral to our success."

Muskoka's product is by their admission and by reputation, of high quality and consistently so. Muskoka Brewery also puts emphasis on maintaining direct human relationships with its customers to instill a sense of trust in the industry. This effort to instill trust is reflected in the company's website content, communicating the company's beliefs. While many food and beverage companies may find benefit in loose labelling standards on their product, Muskoka Brewery has gone as far as explaining a labelling loophole they could benefit from as an alcohol company that is not required to provide a full list of ingredients, but instead use their short ingredients list as a marketing strategy and an opportunity to influence trust in the company.

### "Purity

We believe you should know exactly what your beer is made of. Alcohol is the only consumable product that doesn't legally require a full list of ingredients. What makes Muskoka Brewery different? The ingredients on our labels are what we actually use to make our beer!



Here's what you won't find in our beer. There are no additives, no preservatives and no adjuncts (cheaper ingredients or those that shortcut the brewing process). And we never pasteurize. We brew beer the way it's supposed to be made. This is our passion and our promise." (Muskoka Brewery, 2015)

The brewery is well capitalized and says it invests heavily in people and quality equipment to support those people properly. They are seen as a leader in the industry in how employees are compensated, which works alongside with high expectations of those employees.

### *6.5 Marketing Strategy*

Muskoka has five core brands in stock at all times, which is a notably different strategy than other breweries with one flagship brand and one or two secondary brands. Mad Tom IPA, Twice as Mad Tom IIPA, Detour, a seasonal that shifts based on the season, Cream Ale, and a core Wheat Beer. Detour is their biggest seller, followed by Mad Tom IPA and Cream Ale. By always offering five core brands, the company covers a large fraction of the beer styles gaining the most popularity in the province.

Muskoka distributes through all three major sales channels on Ontario, as well as selling in the States and other parts of Canada. The company recently pulled out of the Western provinces as it was too expensive for the company to justify (see discussion above).

The company relies on local connection and identity with its brand. “If you are up north... and a true cottager, you think of Cream Ale,” (Interview, Kristin MacDonald, November 24, 2015). They balance Muskoka regional nostalgia with innovation in brewing styles and forward-thinking trend starter campaigns.

For example, Mad Tom was the first West Coast IPA launched on Ontario with all three major marketing channels. Muskoka was able to push this marketing campaign with ample resources, which placed them ahead of others developing IPAs. It changed the landscape of beer in Ontario with its visibility, strong backing and far-reaching distribution. This was a forward-thinking campaign on their part, noting that the Ontario market is growing at 24%/year in the IPA category<sup>9</sup>. Similarly, Detour was the first Session<sup>10</sup> IPA in Ontario, launched in January 2014. The company frequently claims space as first movers in the market and reason out which trends are going to “fit us, [that] we believe in,” (Interview, Gary McMullen, November 23, 2015).

Muskoka has had much success with private, independent licensee in Toronto within the last five years, especially the Toronto West End, which has a heavy concentration of licensees. The Muskoka brand is overall well received, and they claim to be one of the fastest growing breweries in Ontario.

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<sup>9</sup> IPAs, or India Pale Ales are a hoppy beer style in the broader ale category, which have gained popularity in the craft beer industry. The reasons for their popularity are up for debate, though it is possible that their hoppy, bitter profile serves as such a distinct contrast to the bland commodity lager that it is a go-to style out of a need for differentiation.

<sup>10</sup> A Session ale is relatively low in alcohol as well as mellow in flavour. Many breweries release these during the summer months as they are meant to be refreshing.

## *6.6 The Future of Differentiation*

A common theme in all interviews at Muskoka Brewery was a concern surrounding the concept of the fake craft brands: that is, brands being marketed as “craft” by the large foreign-owned companies Molson, Labatt and Sleeman. All interviewees took time to analyse the concept of the “Premium” beer in the 1990s as the word that summed up quality of choice, and the gradual adoption of that word within many breweries’ marketing campaigns loosened its parameters. Muskoka projects that the definition of “craft” will prove equally fluid and that through well-funded advertising campaigns, the foreign breweries will be able to likewise convince consumers of the quality of their products. As a result, Muskoka makes a point of prioritizing authenticity in all aspects of their business practices.

## *6.7 Local Economic Impact*

Muskoka Brewery is within the top ten employers in the Muskoka region, and they are of the top five in Bracebridge. The company maintains a strong connection with local conservancy initiatives and is partnered with Habitat for Humanity ReStore.

## *6.8 Sourcing*

Muskoka’s approach to purchasing ingredients and equipment is buy as local as possible. Muskoka’s definition of local appears to be within Canada as first preference and, failing that, North America. The lack of availability of Ontario grown hops and grains has

meant that Muskoka sources ingredients from the closest place they can retrieve the highest quality. Where they cannot get a specific flavour profile for various malts, they do on occasion import from Europe. For example, they have imported small quantities of chocolate malts from a company called Bairds in the United Kingdom, as it cannot be found in North America.

Muskoka Brewery does have a passion for supporting local “when it makes the best business sense” (Interview, Gary McMullen, November 23 2015). They work with local manufacturers wherever possible, and “those products must meet specification, be of good quality and be priced competitively” (*ibid*).

Muskoka does have a history of utilizing local crops for specialty ingredients. In the winter, the company released a seasonal brand called Winter Beard, a double chocolate cranberry stout, which uses cranberries grown close by in the town of Bala, Ontario.

## 6.9 Sustainability

While Muskoka Brewery has not yet formalized sustainability procedures, the company is in the process of hiring a third party sustainability consulting firm to identify opportunities for environmental efficiencies within the company. They will work with this organization to identify their current environmental footprint by their metrics and use that to inform the company’s next steps.

In terms of industry standard sustainability, McMullen noted a number of considerations brewery owners must take into account, though the answers are never

simple nor can they be perfect. He noted that there are often economic impetuses behind a sustainability strategy, e.g. water conservation reducing costs as well as having environmental benefit, and hopes to approach sustainability for the brewery with thoughtful consideration.

### *6.10 Scaling Up “We want to grow rapidly, but we want to grow responsibly”*

The company had been “growing in spite of itself” since its inception in 1996. Many years were hit and miss due to excise tax expenses, with profit and loss statements fluctuating depending on the year. “Under the old tax regime, if you had a good year it was alright, and if you had a bad year it was really bad. We had no ability to withstand any spikes in terms of our earnings” (Interview, Gary McMullen, November 23, 2015). The company had grown at the time through the help of friends and family who acted as a network of thirty-five to forty shareholders holding small portions of the business. They needed to reduce the shareholding numbers and increase the investment substantially to plan for the long-term.

As new taxation policies took effect and the sector experienced growth, McMullen had his eyes out for the right investor. While there were many who could have been a poor fit, he eventually partnered with Bob MacDonald in 2008, who had grown up cottaging in the region. He invested the required funds in the company to hit its stride.

“It’s important to note that those tax changes that were implemented were fundamental to this business getting to where it has gotten to. People from the outside might see overnight success, you can plot our growth rates and see the blips upwards with

each policy change, and finally when the investment dollars came in in 2008 when we got the capital we really needed to hit stride, then it really started to take off,” (Interview, Gary McMullen, November 23 2015).

### *6.11 Company Culture, Employee Satisfaction*

Employees interviewed at Muskoka reported very high job satisfaction and a strong belief in the mission and vision of the company. A number of employees have seen the company through its major growth period; of the two employees interviewed, both anecdotally referred to the time their employee number was sixteen or twenty, and referenced that the workforce has grown to over one-hundred now. They are optimistic about the growth of the company and report they feel rewarded by the company for their work.

To promote morale, the company conducts a number of programs and organizes regular staff retreats. One of these is anonymous in-house company surveys frequently for feedback from employees, which it was reported has been effective in making employees feel heard and valuable.

A similar in-house program, designed to connect employees to the product is the Moonlight Kettle program. Each month the company brews a one-off beer from an original recipe. A brewer from the brewing team will choose partners from anywhere in the company and work as a project team to develop a new beer. “It’s a mini business unto itself where they bring this beer to life, like an innovation pipeline. It gives our people time to

experiment, make mistakes, fail – create time and space for that to happen and to cultivate leaders” (Interview, Gary McMullen, November 23 2015).

Importantly, at the top end, Gary McMullen feels very strongly about the Living Wage Canada program<sup>11</sup>, and hopes to participate as an official Living Wage Organization once the program moves into their area. Management takes in to account the cost of living in the community of Bracebridge, and the various communities where their sales representatives are located and what wage those employees must have to stay in the area. The company has adjusted wages accordingly and presently identifies itself as a Friend of Living Wage Canada and is excited to force the adoption of the Living Wage program in the area.

Overall, the company has a sense of itself as having a “passion for people and for making a difference. Muskoka Brewery as it exists in the beer industry, in Canada and the world, is a vehicle for us to make the difference we want to make in the world – the company gives us the capabilities to make those changes” (*Ibid.*).

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<sup>11</sup> Living Wage Canada is an organization that promotes for wages that “reflect what earners in a family need to bring home based on the actual costs of living in a specific community. The living wage is a call to private and public sector employers to pay wages to both direct and contract employees that are sufficient to provide the basics to families with children” <livingwagecanada.ca>

Muskoka's company value statement is as follows:

**WE have resolve.** We work hard and are unwavering in our beliefs. The connection that we feel to this place that we share has made us strong and determined. We are passionate about beer and we will make our mark. Competition only strengthens our resolve to be a leader.

**WE are authentic.** We draw inspiration from the natural wilderness that surrounds us. Our beers are a reflection of us; genuine and unfiltered.

**WE are thirsty.** We are not afraid to *venture of the beaten path* to create and forge new ways of doing things. That is how we are built.

**WE are caring.** We care about each other and the well-being of our community. We are approachable, understanding, and patient. We strive to make our community a better place.

**WE are all unique.** Our diversity makes us stronger as a team. We support and listen to each other. We teach and learn from each other. We laugh and celebrate together.

**There is only one Muskoka.** It is a special place where rugged granite outcrops and lonely windswept pines meet the shimmering beauty of freshwater lakes. Unspoiled natural beauty is what people find here in Muskoka. This place is our home. It is at the heart of what we brew. Go ahead, taste it.

### *6.12 Ownership & Independence*

Muskoka is dedicated to remaining independent and developing their local economy. The company and its management have had a strong role in lobbying government at the federal and provincial levels for the benefit of small scale, independent brewers. President Gary McMullen spent a number of years as Chair for the Ontario Craft Brewer's Association and places a high priority on remaining authentic, creating jobs locally and remaining a Canadian-owned company.



### *6.13 Perspectives on the Industry*

Policy changes provided part of the fuel for the growth, but Muskoka sees that what is happening in craft beer is part of the larger trend of food and is as a result of the Local Food Movement and notes the growing reconnectedness consumers have with food. Comparing the beer industry to the growth of the wine industry, and noting that the Ontario Government was open to developing that sector they feel “bodes well for the industry.”

All three interviewees from the company noted the concept of a “market correction” or “history repeating itself” in discussing the changing landscape of beer, in developing beer style diversity but also with the relocalization of manufacturing jobs. “Craft beer is the new manufacturing, people are connected to their communities again” (Interview, Kristin MacDonald, November 24 2015).

## 7.0 CASE STUDY: Block Three Brewing Co.



Source: [Blockthreebrewing.com](http://Blockthreebrewing.com)

Block Three Brewing Company was founded in September 2013 by four friends: three accountants and a brewer. The company employs ten people, with six full-time and four part-time. It operates at approximately two thousand hectolitres presently with twenty barrel fermenters.

### *7.1 The Story*

The brewery is located in the centre of St. Jacobs, Ontario, a small town located outside of Kitchener-Waterloo. The town has a large Mennonite population and is a tourist destination for Kitchener-Waterloo residents. It has a large farmer's market as well as a number of artisanally focused shops on its main strip.

The process of opening the brewery began in January 2013, when the four friends had come together to draw up a business feasibility plan. They pinpointed St. Jacobs as an ideal location due to its steady influx of weekend tourists seeking out niche, crafted products. The assumption was that a local brewery would add to the local flair of the town and be profitable.

The partners approached the township to see if it was feasible and the township suggested a building and enthusiastically approved the project. The four partners then drew up a feasibility plan, rented the building, and opened on April first of that year. The four partners placed emphasis on developing a retail space to sell out of. The brewery has an open back end, which allows customers to see where the beer is made and interact with the brewing process.

The partners developed their marketing strategy from a piece of advice they were given by an LCBO representative: “own your backyard,” which meant developing their business locally in the Kitchener-Waterloo region. This means logistically they do not need to hire extra delivery people nor sales reps. They sell through craft beer bars in the area, but most of their volume is sold directly from their retail space. They have approximately 30-40 licensee accounts in the area, but the retail space allows for the highest margin and allows for the most genuine brand interaction with the customer.

## *7.2 Challenges*

One of the owners, Graham Spence, described the major challenge as “getting [the] product in front of customers,” noting that Ontario alcoholic beverage retail laws are prohibitive to small businesses and cater to larger companies, referencing the macro brewers, but also larger craft breweries that have reached certain economies of scale<sup>12</sup>. Owners of this brewery noted that the nature of craft beer and smaller businesses is that

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<sup>12</sup> Among these larger craft brewers were Muskoka and Beau’s.

they are inherently inefficient. “What would take them two people to do, might take us five people to do. We don’t have automation... we are an inefficient operation compared to them.” The owners of Block 3 feel that the beer retail policies in Ontario are hindering the growth of the industry and employment for people in the province by creating a number of barriers to entry for start-ups.

Another challenge noted was the competition for tap space with licensees. While the brewery has a quality product and good brand recognition, at times these two factors will not be enough in the competitive craft brewing market. There are a number of breweries that will move volume and compromise their price point to undercut the competition, which Block 3 cannot afford to do. Block 3 strictly sticks to their prices and notes frustration with the competitive, cost-cutting market.

Owners at Block 3 also note the trickle-down effect of legislation and policies and the basic logistical disadvantages they can cause. For example, as a small start-up brewery, distribution requires coordination, labour time and mileage costs that are all absorbed by the brewery. An LCBO policy that was recently changed<sup>13</sup> dictated that “cottage” brewers (i.e. under 75,000 hectolitres) could only deliver to points of sale (i.e. LCBOs, TBS, licensees) directly, or use the TBS distribution services. Small brewers were not allowed to pool deliveries with each other, or use a third party distribution service. In that sense, the macro brewers have the advantage of having The Beer Store’s in-house delivery services to deliver for them at no extra cost to them. Spence expressed that he found this unfair.

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<sup>13</sup> As will be discussed in the policy analysis section of this paper.

Block 3 also noted that their major competition after the foreign owned breweries are contract brewers. The idea behind contract brewing is that one could contract out all the services to have beer brewed with a generally hands-off approach and create a marketing experience of being a small scale craft brewery. “It goes against the OCB definition of craft beer, they’re kind of cheap money makers and are just marketing companies at the end of the day” (Interview, Graham Spence, December 15, 2015).

To the question “what do you wish you had more resources to do?” Spence explained that the organic growth of the company has meant that there is not a wish for further resources. If there were more capital, they may open a brew pub in downtown Kitchener. The brewery will be investing in a bottling line as its next major step, which will increase efficiencies. Labour, packaging and taxes were cited as the greatest expenses to the brewery.

It was also noted that acquiring licencing was a lengthy, bureaucratic process in the start-up stages, that took a number of months during the period of time the brewery was under construction. The general sentiment was that the licencing process felt prohibitive and discouraging to the new entrepreneurs. “It just took way too long. It could have been weeks, but it was months” (Interview, Graham Spence, December 15, 2015).<sup>14</sup>

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<sup>14</sup> I attempted to obtain more information about the licencing experience, but my main contact, Graham, could only speak about it vaguely, explaining that it was his business partner who was tasked with the process. That partner was unavailable for interview.

### 7.3 Successes

Block Three's greatest strength has been its welcoming retail space and its company atmosphere.

The company has actively involved itself with its surrounding community, maintaining presence at local events and engaging with the residents of St. Jacobs and the Kitchener-Waterloo region. This type of outreach bodes well for the brewery's following and creates return customers. The brewery has a mug program, where return customers can have their own mug on site that is theirs to drink from when they come in to the space, which "creates a sense of local pride." They had these mugs made by a local potter, which adds to the authenticity of the program. "It makes people feel like they are a part of Block 3, it's personal recognition" (*Ibid.*).

The brewery has also given itself a niche edge by brewing Belgian beer exclusively, which has a unique flavour profile, and is cheaper to brew due to lower hop content (which are often the most expensive ingredient) and quick product turnover (because it ferments and conditions quickly, unlike lagers). Spence noted that not a lot of breweries are brewing Belgian beers on a full-time basis. Further, a mild Belgian Saison will often have a similar crispness to a lager, meaning it is an accessible introduction to alternative beer styles for those used to drinking a commodity lager from a macro brewery.

Graham attributes much of the brewery's success to having a business plan laid out and a keen eye for size-relevant efficiencies, financial literacy and cost effectiveness. "If you put the time and energy into doing a business plan, you can be successful. You need a balance of people with ideas and people with the business sense" (*Ibid.*). Block Three was

started with a low input model, in that the owners invested in the base requirements for a minimum output – they started with three barrels – and sold out in twenty-four hours. This has meant that they have experienced organic growth and have been actively working at growing responsibly as they continue to sell out of product. Spence noted that many breweries that opened at a similar time to Block Three opened at large capacity and were generating volumes that did not have guaranteed sales, which seemed too high risk to the owners of Block Three.

Spence reported that funding the brewery was relatively easy. The owners approached the bank with a well prepared business plan that the bank was impressed with, putting few things at risk, taking out minimal additional debt. They did not leverage on investors, and do not at present intend to.

#### *7.4 Ingredient Sourcing*

Block Three sources its ingredients and materials “as local as possible,” though there are limited channels to acquire basic brewery necessities in Canada. Block Three acquires its malt from Canadian Malting, and is not opposed to sourcing specific malt varieties from Europe if need be. As for hops, some are sourced locally from Ontario, though not a large percentage as there is no maturity to the hop supply in Ontario to sustain the beer industry.

Spence noted that the company sources bottles from Spain, which feels redundant as the brewery is located on the same street as an artisanal glassmaker with many more in the region, but they do not make industry standard bottles.

### *7.5 Perceptions of Growth in the Industry “We were told what to drink for too long.”*

Block Three’s sense of the industry’s growth is that a first mover followed by a snowball effect took place since the 1980s. There was a gradual realization that beer was more than the yellow lager, and we all have different palettes. “All it took was... the first person that went out and did it and produced a good quality product and growth happened from there. The possibilities have changed in the sector” (Interview, Graham Spence, December 15, 2015). Block Three, similarly to other breweries, refer to the growth of the sector as a “market correction” as opposed to a shift.



## 8.0 Discussion

### *8.1 Common Success Factors*

The majority of interviewees attributed the growth of the industry to the prevalence of social media and information sharing. With internet-based channels, consumers have been able to engage with beer products in a manner impossible before those technological advancements, a stark contrast to the mass televised advertising campaigns of Molson-Coors and Labatt of the mid-20<sup>th</sup> century, which positioned lager as commodity beverage for mass consumption (McLeod, 2014). Through social media sites such as Twitter, Instagram and Facebook, which are all free to use, small scale brewers with minimal budget or time for marketing and promotion can advertise and engage with consumers directly. Of the four breweries interviewed for this paper, all utilize these three main channels of social media. Beau's All Natural consciously opted to cut costs by utilizing in-house marketing techniques with social media channels at the core of its marketing strategies and relied heavily on word-of-mouth. In bypassing major marketing and advertising channels such as television, radio and print media, these small to medium scaled enterprises avoided unnecessary costs and were able to build on direct identification with their brand.

In the early days of the industry, those who followed craft beer self-identified as "beer geeks" and would participate in online forums such as [www.ratebeer.com](http://www.ratebeer.com) or [www.beergeeks.ca](http://www.beergeeks.ca). Two interview subjects for this paper proudly claimed to have been active users of [ratebeer.com](http://ratebeer.com), particularly in its earlier stages, and claim to be well networked among the growing beer industry as a direct result of their involvement with

the website. Favourable reviews on any of these self-proclaimed “beer geek” websites, especially in the early 2000s, would build word-of-mouth recognition for an otherwise unknown beer brand and generate demand for the product. Clemons et. al. (2006) argue that there is a correlation between high internet ratings on a beer product and its sales growth, a common observation in niche markets. There is a sense among the craft beer industry that the community has its origins in these online fora and recognizes breweries that achieve high ratings.<sup>15</sup>

The perceived benefits of social media marketing for start-up companies cannot be denied (Celuch, 2014; Murphy et. al. 2007; Clemons et. al. 2006). Many small brewers’ only connection with the growing industry prior to social media, especially when situated in rural settings such as Church-Key Brewing, were quarterly publications or occasional conferences once the community of small brewery owners in Ontario became large enough. Research has shown the benefits of internet-based communications and promotion to SMEs in the twenty-first century (Celuch et. al., 2014; Sparkes & Brychan, 2001). The existence of well-developed social media channels at this moment of industry critical mass has provided small brewers a cheap and effective marketing channel where there did not used to be one. For the sake of future studies, it would be interesting to explore the role of social media channels in aiding in the development of local food networks in Ontario.

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<sup>15</sup> In my own experience as staff at a brewery with particularly high ratings on ratebeer.com, I was instructed by my superiors to push this fact as a central component of sales pitches.

## *8.2 Know Your Own Backyard: Local Focus & Company Growth*

A major success factor noted in all four case studies was the concept of starting the business by developing locally-focused sales channels and a locally-embedded company identity. Each case brewery is located in a rural or semi-rural setting, where the brewery acts as a destination point. The growth of these companies in rural communities has helped generate a sense of place for locals and appears to have generated local tourism in each locale, which is in keeping with Plummer's (2005) findings that revealed the value of beverage tourism to stimulate local economic activity. All four brewery owners or presidents noted a sense of local pride in their product, with Steve Beauchesne referring to support of Beau's beer in the Ottawa area akin to "supporting [their] local sports team." By using a locally-focused model, the four brewers studied have created jobs in their communities and created or added to sense of place in their local economies. Muskoka Brewery is among the top five employers in the Bracebridge area, while Beau's is similarly one of the largest employers in Vankleek Hill. Beau's also brings in upwards of 14,000 visitors each year for its Oktoberfest festival, a tourism presence that far outstrips the town's population of around 2000 (Statistics Canada). Each company maintains an active role in its community by sponsoring local charities, events and community initiatives. Each company's branding and slogans nod to their local identities, with Beau's tractor symbolizing its small town roots; Block Three acquired its name from the first plot of land deeded to one of the first settlers of the area and names its brands, such as Pushbroom Porter, after iconic artisanal goods made in the town. Church-Key appeals to its local history and identity in a number of ways, the most obvious being its honouring of the church building it is housed in; Muskoka has used iconography of the Muskoka chair, pine

trees, and various other cottage symbols in its branding. Shuman (2013) argues that vibrant networks of small businesses at the local level will have the strongest impact on economic prosperity and are some of the biggest agents in creating local cultural identity. The four breweries listed here exemplify this concept.

The casual nature of distribution channels such as small, independent licensees has contributed to the growth of the industry. The ease of relationships between similarly scaled SME's (Lester; Lipinski, 2015) has meant that craft brewers have had an available sales channel that may not have been present without the local food movement, a sentiment all four brewers interviewed share. McMullen described the nature of these sales relationships in the early days of the brewery to include a significant amount of education, since the local licensees had not developed a taste for the product in the 1990s and early 2000s. Through cultivating close relationships with these licensees Muskoka was able to work directly with bar and restaurant owners as well as consumers to generate interest in its different styles of beer.

While Church-Key is unique in its intentions to remain relatively small scale, the four brewery presidents expressed differing definitions of local scope on both the supply chain and marketing ends and what it means to their business model. Ingredient sourcing provided for rich discussion in this regard since available channels are limited in Ontario. Older breweries such as Church-Key and Muskoka described their experiences sourcing malt exclusively through Canada Malting in their earlier years, which was the only supplier at the time. Canada Malting is a subsidiary of the international company GrainCorp Malt group, so even if the grain is exclusively Canadian grown, the company itself is not

domestic. The general sentiment was that sourcing locally meant sourcing North American, since to source from a national or provincial scope would mean very limited access to resources. While each company's president expressed that they would ideally source all ingredients and equipment locally (from Ontario) if available, the common sentiment was that required ingredients and equipment were either not available locally or the supply was limited, unreliable or expensive. The common theme was to address those decisions with a nuanced approach, taking into consideration a desire to support local while also accounting for other factors such as cost, availability and quality.

In terms of geographical sales markets, each brewery at least began its business model with a local focus. Gary McMullen at Muskoka noted that there was a personal touch that differentiated Muskoka Brewery from other breweries. He noted that the company's strength was that employees maintained a connection with customers and "someone would always answer the phone [for customers]." Of the four case studies; Muskoka is the largest company as of Fall 2015, with the company vision "to be Canada's most trusted and iconic beer brand," revealing Muskoka's sense of itself as a nationally recognized brewery. In its earlier years as a small brewery, Muskoka primarily appealed to the Bracebridge area locals and cottage owners, with its earliest brands resonating with many as an essential symbol of local identity. Muskoka's outward expansion goals took effect after 2009 when the company gained a major investor, which speaks to the fact that Muskoka operated for thirteen years with its sights on almost exclusively its locally available markets.

Church-Key Brewing is unique among the four cases as the company was started with the express intention of remaining small and community-minded and placing

conscious limits on the company's growth. Owner John Graham sought to open his own brewery for the work-life balance he hoped that being his own boss would provide. Graham noted a number of tensions inherent in remaining a small-scaled company in a system he feels offers power to larger companies.

Block Three drew up its business plan in 2013 with a consciously local focus. The brewery was given advice from local LCBO representatives to build its business locally through in-house retail and licensee relationships. Thus far, this appears to have worked well for the brewery.

The discussions surrounding the New West Partnership were revealing in gauging perceptions among the four craft brewers of what qualified a local market. The two most extreme examples were Muskoka Brewery and Church-Key Brewing. Since the Alberta government used this partnership agreement to give preferential tax rates to local producers of alcohol, Muskoka Brewery pulled out of Western Canada, as costs to distribute there became too high and discouraged competition in the region. Muskoka Brewery's president expressed that he was a heavy proponent of a universal progressive tax structure for the industry, so that breweries could compete anywhere in Canada with the ability to grow into tax rates. This position was a stark contrast to Church-Key's owner, John Graham's stance on the matter. As a brewer with no interest in expansion to Western Canada, he felt that craft breweries that were lobbying for the right to compete in the Western Canada market had possibly become too big and ran the risk of running small brewers of roughly the same scale as his brewery out of their markets. These viewpoints

revealed that the definition of local spans from all of North America, to Canada and to Ontario depending on the point of discussion for brewers.

### *8.3 Company Growth*

Company growth was commonly regarded as a loaded term that required further discussion and explanation from three of the four brewery presidents. Growth as a goal unto itself seemed to be associated with the macro brewers or large multinational companies. Each discussion on company growth goals led immediately to a reflection on business ethics and assigning value to those growth goals beyond finances – none of these were strictly economic nor financial discussions. This notion of growth as at worst potentially harmful or at best requiring added nuance echoed Victor's (2008) notion that growth as a policy objective in a macro economic sense is narrow minded, does more harm than good by overuse of resources, and does not inherently promote prosperity. These discussions about company growth goals offered some micro, firm-level context to these broader ideas.

At Beau's All Natural, owner Steve Beauchesne expressed "growth is not the goal, it is a symptom. If we are doing the right thing the right way, we will be rewarded with growth. [We are] neither anti-growth, nor pro-growth... we're too big if I can't sign the Christmas cards to our customers, or if one of our accounts wants to do a beer dinner and I can't accommodate." Beau's is an interesting case study in this regard as Beauchesne seems to view his business as an experiment to see how successful the company can be while maintaining its business ethics. Until recently, business ethics and economic growth have

been viewed as mutually exclusive, though there is growing acceptance of contingencies between the two (Eisenbeiss et. al., 2015) as evidenced by the success of Beau's. He explained that his goals for company sustainability come before any goals for growth. "Growth has allowed us to do some of the things that make us a better brewer. We are not too big if we are able to afford new equipment that in turn can improve the quality of our beer."

By contrast, at Church-Key, John Graham not only intends to remain a sole proprietor, but has maintained production levels of two thousand hectolitres per year. He expressed in our interview that he felt that by remaining small, he could be resilient to major economic shifts as well as remain accountable to himself and his community. He also feels very strongly about maintaining the work-life balance that running a steady, small company can provide. He readily criticized breweries such as Beau's for having no set cap on company growth, as he feels it is central to business ethics.

The largest case brewery, Muskoka, presents itself as a nationally-scaled brewery and has intentions to be so. However, there was still rich discussion with president Gary McMullen regarding the struggles with economies of scale – i.e. that Muskoka was at a disadvantage for being its size compared to the macro brewers - and the problems inherent in growing too large. McMullen expressed the sentiment that "unbridled capitalism is never good," which influenced much of our discussion. Similar to Beau's, McMullen expressed that the company's ethics were "worked backward from" to get to its yearly growth goals. "We want to be clear on why we are here and what makes our heart beat. [As a company] we want to make a difference in our communities and the world... [we see ourselves as] taking



up a leadership position in the industry to fight “untoward activity” that the macro brewers may have created for us. We want to grow the company rapidly, but we mostly focus on our team making a difference in the world and we work backwards from there” (Interview, Gary McMullen, November 23, 2015). In this case, there was no cap on company growth as the greatest virtue of company ethics, but an approach that is similar to the triple bottom line or shared value approaches (Elkington, 2004; Kramer & Porter, 2011).<sup>16</sup>

Block Three had little to say on the abstract idea of company growth, in part because it is still in its start-up phase. However, there were a number of sentiments expressed that nodded to the challenges of being a new, small start-up with no economies of scale in a market that they felt favours companies with economies of scale.

The differing perspectives of what growth targets look like for each brewer offer further questions regarding ideal growth goals for SMEs that seek to contribute to local economic growth. The concept of company growth is quite broad and complicated, but it conjured up a number of sentiments regarding the problems inherent in uncapped growth, and company values.

To marry the economic discussions surrounding craft beer, on the one hand we have Swaminathan’s (2013) resource partitioning theory, which explains the movement as a number of specialists rising to meet niche market needs while generalists (i.e. the macro brewers) meets the broader need of supplying the commodity to the market in its most basic form, while on the other hand we recognize craft beer as a possible rise of a more

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<sup>16</sup> Notably, when McMullen was pointedly asked about growth goals, his answer was immediately a description of the company’s why statement – and not a percentage that I was expecting.

equitable economic market that does not necessarily value growth above all things. The two do not appear to be mutually exclusive; resource partitioning serves as an explanation to what market demands may have driven the growth of the craft beer segment initially, though a low growth, or steady-state macro economic model explains what factors may lead to the sustainability of this industry as a specialist field. If a low-growth model values localized prosperity at a community level above GDP growth, then breweries which have been shown contribute to local economic well-being (Menna; Catalfamo, 2012) should be ideal firms to flourish in a more balanced economy. Certainly, there can continue to be a place for generalist organizations such as Molson-Coors and Labatt to serve a segment of the market, but ideally the market should be more equitable for new entrants and SMEs that do not wish to grow to the massive scale of the macro brewers.

#### *8.4 Efficiency*

Efficiency was unsurprisingly a loaded concept in each interview. Given the history of the drive for economy of scale, Ford assembly line tactics and the value of providing the consumer with the lowest price point possible that defined the beer industry in Ontario for so many years, the four case brewers held a self-consciousness surrounding their “inherently inefficient”<sup>17</sup> operations. The smallest brewer, Block Three, used the phrase “because we’re inherently inefficient, we are at a disadvantage” in response to a number of interview questions including sales tactics and packaging. Their definition of efficiency was overarching and suggested that not having an economy of scale like the macro brewers did

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<sup>17</sup> Graham Spence, December 2015; Gary McMullen, November 2015

placed them at a disadvantage. Mainstream economic theory of efficiency generally assumes that firms seek to maximize profit by minimizing the input used to produce a given level of output (Stigler, 1987). In this sense, the brewers were referring to adding technological efficiencies to their operations. Technological efficiency can be defined as the ratio of the amount of benefit derived per unit limited resource (Ayres, 1989).

Church-Key is a similar size and owner John Graham noted that certain specific efficiencies, particularly environmental ones, in operational systems could be attained, but his goal has always been to have a steadily running small business.

Most interesting was the discussion of efficiency with Muskoka president Gary McMullen, who questioned the very concept and drew connections with Victor's (2008) critique of progress, efficiency and economic growth being an end instead of a means. He used the regulated alcohol sales systems in Ontario to make a powerful point about the short-sighted nature of defining efficiency in such narrow terms: "What does efficiency mean in the context of economic prosperity? A beverage alcohol retailing system that has three thousand drop points [of sale] compared to the one in Ontario now that is half of that is not as efficient at delivering beer to market, but it sure does leave more money in the economy. And when there is more money in the economy you have twenty-thousand more people working in the industry, making money, sticking it in their pocket and then spending it ... I think we have to learn that maybe efficiency is not the king, and perhaps it's [about] balance" (Interview, Gary McMullen, November 23 2015). He also expressed that despite not having the economies of scale or vertical integration that the foreign-owned

brewers had, there was inherent value in being a genuine company and making beers true to style.

At Beau's, efficiencies were discussed in a more direct way. Beauchesne expressed, similar to Block Three, that with more financial resources the company could invest in equipment to increase efficiencies to streamline processes. This is interesting since the two companies are at very different sizes and possibly speaks to an efficiency treadmill effect that business owners inevitably end up on. Binswanger (2006) speaks to economic treadmill effects on individual well-being – particularly the time-saving treadmill, which assumes we will find technological opportunities to save time anywhere we can, but that we will always necessarily fill any extra time saved through those efficiencies with new issues, creating a paradox. A future study on the treadmill effect on increasing efficiencies in SME business practices would be interesting.

The concept of efficiency evoked similar responses among the case breweries, with a common self-consciousness regarding inherent inefficiency based on company scale at each brewery size represented here. Only Church-Key expressed a contentedness with its efficiency of operations, which perhaps stems from that brewery's lack of interest in growing any larger than it is.

## 8.5 Sustainability



Source: Google image search: Used.ca

The concept of sustainability was addressed in each interview to varying degrees. To spark this conversation, I asked each brewer what their stance was on industry standard packaging, referencing the stubby bottle which went out of circulation in 1983. The stubby is often referred to as the pinnacle of industry sustainability, as each major brewery at the time (of which were almost exclusively macro brewers) used and recycled the same bottles<sup>18</sup> in a reciprocal agreement (CBC, 1983). The stubby was ditched for the long neck bottle, as differing bottle shapes and sizes allowed for higher visibility, differentiation and branding opportunities. Their responses revealed much about their individual stances on sustainability regulation in the private sector and their own priorities when it came to applying sustainability principles to their businesses. Of the four breweries, two championed sustainable business practices and held deep opinions on the

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<sup>18</sup> These bottles could be washed and reused an average of 20 times.

role of sustainability within their businesses. These two were Beau's All Natural and Church-Key.

At Beau's, sustainability and a broader sense of business ethics combined with marketing thereof has been a key strategy to the business' success. Beau's is a certified B Corporation, a third-party certification organization that requires its companies to "meet rigorous standards of social and environmental performance, accountability, and transparency" (B Lab, 2015). The certification standards go so far as to require that companies incorporate certain accountabilities into their Articles of Incorporation and legal governance structure as a commitment to the mission of the company and to provide legal protection of that mission. Further, B Corp requires regular, stringent reporting on the impact of its businesses utilizing B Impact Assessment.<sup>19</sup> The word Steve Beaudesne used to describe his approach to sustainable business practice was "mindful," a word that was used to encompass taking all things into consideration, but placing sustainability and company integrity at the forefront of the business – an approach that has led to the company's financial success. There is growing research and an increasing number of success stories to suggest that this approach to sustainability has been a strategy for success for SMEs (Eisenbeiss et. al., 2015) and the added value of B Corp reporting accountability strategies adds to evidence of the viability in incorporating sustainability into business practices. Beau's provides a case study to support these claims.

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<sup>19</sup> Business ethics reporting metrics and accountability can be subjective and have their own body of research on their effectiveness, though there is a growing respect for the Benefit Corporation movement and the B Impact Assessment metric (Ng, 2013).

To the discussion surrounding industry standard bottles as a vehicle for industry-wide sustainable practices, Beachesne was quick to point out that the impetus behind the macro brewers using standardized bottles at the time was cost effectiveness and that to hold up any one practice as the only way forward lends to dogmatic thinking about what sustainability and environmentalism is. It is worth noting that Beau's packages their beers in unique, non-standard bottles.

By contrast, in the case of Church-Key Brewing, the integrated sustainability approach looks quite different. Owner John Graham self-identifies as an environmentalist and, as mentioned in the case study, ran for office under the Green Party of Canada. He has always sought to integrate sustainability into his business practices and is proud of that fact. When asked about the industry standard bottle, of which there are a number that line the walls of the brewery, Graham held strongly that the stubby was the pinnacle of environmentalism in the industry and was highly critical that something so practical and environmentally impactful had lost its place in society to marketing interests.



Source: Church-Key Brewing. <[www.churchkeybrewing.com](http://www.churchkeybrewing.com)>

At Muskoka, sustainability has not historically been at the forefront of the business model, but the company will be hiring a third-party consulting firm to identify environmental efficiencies to adopt. President Gary McMullen spoke to the fact that the stubby had been to beer companies' economic benefit during its reign between 1962-1983, and was not an environmentally-based decision at all.

Sustainability was not as prominent a discussion at Block Three, but when asked about standardization of packaging part-owner Graham Spence was skeptical about a practice that would limit brand differentiation, as they rely on product and brand differentiation for their company strategy.

### *8.6 Industry Camaraderie*

Feedback from each brewery revealed a sense of community and camaraderie among craft breweries. Steve Beauchesne expressed that his favourite thing about the industry was that he is friends with a number of other brewery owners and industry workers – including John Graham, owner of Church-Key. Jeff McCauley expressed that in his role at Beau's, "there is a lot of collaboration with other brewery purchasers/owners, whereas purchasing in other industries can be very competitive, even secretive" (Interview, Jeff McCauley, December 9, 2015). Craft brewers are ready to share their secrets of the trade and they often collaborate on speciality one-off products, or if a fellow craft brewer is located close by, share ingredients when one is running short.<sup>20</sup> Beauchesne discussed

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<sup>20</sup> Casual industry knowledge of my own experience working at Black Oak Brewing Co.



something he referred to as “the good of craft,” that is, the friendliness, collaborative nature, passion and integrity of the industry. He feels that “we’ve got something special that needs to be protected. It’s not just Labatt buying us little guys out, it’s the venture capitalists coming in to the industry looking to make millions and get out – if they don’t have the good of craft at their core, the industry will change into a typical, competitive industry... we’re anti-business (in this industry) in so many ways, and that’s what makes it so special. Nothing worries me more than losing that” (Interview, Steve Beauchesne, November 11, 2015).

It is interesting that with the present growth of this industry, as it approaches market saturation, these entrepreneurs would not view their peers as competitors. Perhaps this can be attributed to the fact that many breweries focus the majority of their sales in their immediate area, but it likely has more to do with the passion of these entrepreneurs running so deep that they are pleased to see the success of the industry in whatever form it takes.

### *8.7 Financing*

A point of interest from the four case studies was the differing stories of each company’s start-up capital procurement. When asked about start-up challenges, Beau’s, Church-Key and Muskoka Brewery offered their anecdotes of difficulty in financing through a banking system that was skeptical about lending to beer entrepreneurs at their times of opening, which were 1996, 1999 and 2006 respectively. By contrast, Block Three volunteered that securing financing through a conventional bank to open that brewery in

2013 was a point of ease. A proven strength Block Three had in this regard and more broadly in the success of the business in its short lifespan thus far was presenting a well laid out business plan (Becherer; Helms, 2009), aided by the professional accounting backgrounds of three of the four owners. Similarly, one could make the argument that the professional background of Steve Beauchesne of Beau's All Natural as a business analyst is evidence of a skillset that contributed to the success of Beau's. Research indicates that the adoption of effective strategy based on previous entrepreneurial or industry experience can help reduce impact of resource shortages that are inevitable when in start up phase (Harris; Gibson; McDowell, 2014).

While the two largest breweries did not discuss hard figures, the smaller two breweries interviewed<sup>21</sup> offered very different interpretations when asked "how much would it cost to open a brewery?" Feedback from Church-Key, which dealt with start-up costs in 1999, estimated roughly \$1,000,000 to account for real estate, equipment, insurance, ingredients and any other inclusive costs. By contrast, the entrepreneurs at Block Three, whose estimations are based on experience from 2013, estimated \$250,000 with no hesitation. The differing viewpoints of these two brewery owners reveals an interesting generational difference in the landscape for beer entrepreneurs between the late 1990s and now, and speaks to the present maturity of the industry. While it is difficult to pinpoint exactly what accounts for cheaper start-up costs now versus then, the perception of these differences is quite telling. By John Graham, a seasoned beer entrepreneur's perception, the financial barriers to entry would have increased due to

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<sup>21</sup> It was easier to discuss financing with the smaller companies; the larger ones were well financed and preferred not to discuss in detail.

inflation, hiked real estate prices and the lack of availability of used equipment. However, my understanding<sup>22</sup> is that with regards to availability of equipment and supplies, ease of acquisition should increase as the shakeout side of the industry continues, as start-up breweries that fail would theoretically sell their equipment.<sup>23</sup> Gary McMullen also noted in his interview the increasing number of North American brewing equipment manufacturers since his company's earlier years. Graham did express that at the time of his start-up, suppliers and equipment only had one channel and it is a basic economic principle that increased competition lowers cost of products (Smith, 1776) so it is quite possible that Graham's bias stems from his long tenure as a brewer through more difficult times.

Financing a brewery has also become a more accessible feat due to grant opportunities through the Government of Ontario since the introduction of the Ontario Microbrewery Strategy in 2011. In 2014, the Ontario Government provided nearly \$3.5 million in funding to various breweries throughout the province through programs such as the Ontario Local Food Fund, the Rural Economic Development Fund and various other economic development programs. Beau's All Natural received \$354,000 in 2014 through the Ontario Local Food Fund (Government of Ontario, 2014), and Block Three was the recipient of \$35,000 through the Rural Economic Development program. Block Three's intended purpose for this funding is to purchase new bottling and labelling equipment "which will enable the firm to produce larger quantities of its product, expand distribution,

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<sup>22</sup> From experiences with brewery start-ups outside these case studies: Together We're Bitter Brewing Co-op in Kitchener Waterloo that opened February 2016 acquired cheap, used brewing equipment from Bavaria. While I was not provided with full costs of their equipment, they acquired their equipment with ease.

<sup>23</sup> Hard numbers data has been difficult to prove and obtain using this particular method of case study research. Since these companies are small and privately owned, requesting detailed financial information is generally frowned upon. I wonder what my results would have been had I approached these companies as a BBA student analyst, and whether I would have been met with defensiveness.

and increase traffic to its tasting room,” (Government of Ontario, OMAFRA news bulletin, September 2015). To place these figures into perspective, the cost of a standard bottling line, an essential piece of equipment that impacts branding, quality and shelf life of the product, has been quoted at anywhere between \$50,000 to \$100,000 depending on the size, quality and whether it is being bought used or new.<sup>24</sup>

### *8.8 The Market Correction*

Each case brewery sees the growth of the craft beer industry as a “market correction” as opposed to a shift or a new development. Gary McMullen of Muskoka refers to it as the “rebirth of the industry.” Steve Beauchesne explained “if you think back to the time before craft existed ... the marketplace was shaped 80% macro and 20% imported premium beers. Those imports were evidence that there was a market for differentiated beers, and there were people who were looking for something good if they didn’t like the basic lager. But the problem with imports is necessarily they won’t have that freshness people look for. That 20% are looking to Ontario to provide their beer now.” He also feels that craft may reach market saturation at 15% (Beer Canada’s<sup>25</sup> 2015 Annual Report, released in early 2016, cites craft at roughly 10% currently). Beauchesne’s view is that ideally craft will reach 15-20% market share and will probably never go above 50%. This view is in keeping with the resource partitioning theory (Swaminathan, 2010) and the long

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<sup>24</sup> Casual knowledge from working in the industry.

<sup>25</sup> Beer Canada is the trade association that represents the macro-brewers on a national scale, though a number of smaller-scaled brewers hold membership such as Muskoka Brewery.

tail theory (Anderson, 2012) that have been used to account for the growth of craft markets in other regions.

### *8.9 Common Challenges*

Representatives of each brewery noted the concept of “fake craft” as a major challenge facing the industry. By fake craft, interviewees were referring to the concept of brands owned by macro breweries being marketed as craft. Indeed, in 2014 Labatt was reported to have spent \$2.7 million on marketing a pre-existing brand under their umbrella as craft (AB-InBev, 2014; Appendix II). With the craft category growing at such a rapid clip in the LCBO, it is unsurprising that the macro breweries are responding to their loss of market share. Brewers interviewed for this paper were unsure of the way forward with this particular challenge, however there was diversity in stances on whether this particular competition was detrimental to the growth of craft. The president of Beau’s All Natural’s stance was that he felt these pseudo craft brands would act as a gateway to real craft for the mainstream beer drinker.

All interviewees from Muskoka Brewery commented on the threat of the fake craft brands and expressed their greatest challenge to be differentiation in the face of this competition. It is possible that this particular brewery responded so viscerally to this challenge because as one of the largest craft breweries in Ontario, this brewery may be positioned to act in more direct competition to Molson-Coors, Labatt and Sleeman compared with the other breweries studied here. President Gary McMullen noted that

Muskoka's disadvantage compared with the macro breweries was in its economy of scale, but ultimately believes that "efficiency is not the king" in creating quality beer.

In a similar vein, the newest, smallest brewer, Block Three, expressed their major challenge in the market to be contract brewers. Contract breweries are those that contract out any part of the brewing process, whether it is space and equipment where a hired staff member brews at a location not owned by the brewery, or paying another brewery to produce the product in its entirety to be branded with the name of the contractor. As a new brewery operating out of a brick and mortar facility, the sentiment is that contract brewers are not the real deal in terms of being a craft brewer. Common to these challenges is a tension and defensiveness in defining what constitutes real craft versus what others who are not reigning true to the definition of craft are doing.

Brewers that hold membership with the Ontario Craft Brewers Association are welcome to use the OCB seal in their branding, and the LCBO does discriminate in terms of only allowing Ontario craft brewers as defined by the OCB placement on designated Ontario Craft Brewer's shelves. It is interesting that third-party certification for craft brewers has not been put forward as a potential solution, though it is possible that these brewers feel their membership with the OCB is certification enough. There have been findings to suggest that the marketing efforts of the OCB have been successful in this regard already, so perhaps the answer lies in continuing to develop those efforts (Oppenheimer, 2008).

## 9.0 Sales Channels: Analysis & Discussion

This section will expand upon some of the major feedback the craft brewers interviewed had in selling their product through the sales channels available to them. Some key themes throughout were: difficulties in dealing with large, publicly run organizations such as the LCBO as a small scale company; limited merchandising opportunities with the LCBO, TBS and grocery retail; and the high costs of working with TBS. The most notable was the discrepancy in power dynamics between small scale brewers and large retailers, though the nuances inherent in the in-person sales relationships provide rich discussion for solutions to these major challenges.

### *9.1 On-Site Retail*

Ontario breweries are able to sell product on their manufacturing site. A number of interview subjects for this paper agreed that selling through on-site retail is by far the most profitable method of selling product, as margins can remain high with no middle man. This method also allows for a face-to-face interaction between brewery employees (or owners, depending on the size of brewery) and consumers. There are a number of limitations placed upon brewers in operating a retail store, and the model allows for very little expansion in this regard.

“CRITERIA AND REQUIREMENTS FOR AN ON-SITE BREWERY RETAIL STORE

- The applicant must be a brewery with a valid manufacturer’s licence issued by the Registrar.
- The applicant must submit to the Alcohol and Gaming Commission of Ontario a properly completed application form for an On-Site Brewery Retail Store Authorization, together with the necessary supporting documentation.
- Where the applicant seeks to operate one on-site brewery retail store, the store must be located on the same parcel of land as the applicant’s main production site where the full brewing process takes place. The full brewing process includes, without limitation, mashing, lautering, boiling, hop separation, fermentation and packaging.
- Where the applicant seeks to operate two on-site brewery retail stores, one store must be located on the same premises as the applicant’s main production site where the full brewing process takes place and the second must be located at another production site of the applicant where the full brewing process takes place.
- The applicant is eligible to apply for authorization to operate two brewery retail stores, provided that each brewery retail store is located at a production site of the applicant (as set out above) and provided that at least fifty per cent (50%) of the beer sold in each store is made by the applicant at the site of the retail store where it is being sold.
- The applicant must make all of its products in Ontario using the full brewing process including, without limitation, mashing, lautering, boiling, hop separation, fermentation and packaging,” (AGCO, 2016).

Beer tourism has been a great benefit to small scale brewers operating in rural areas of Ontario, especially those with a storefront in a tourism heavy centre (Plummer et. Al., 2005, 2006), as was the strategy at Block Three Brewing. Block Three also expressed that with more financial resources, their expansion strategy would be to open a brew pub to build on the brand awareness that their on-site retail store has created.

## 9.2 *The Beer Store*

Brewers Retail is the main sales channel for breweries of all sizes in Ontario, operating under the trading name The Beer Store (TBS). To sell through this channel,



breweries must pay a listing fee of \$25,880 (Brewers Retail Inc., 2014) upfront to list in 100 stores. “This fee is made up of the one-time base listing fee of \$2,880 plus the one-time fee of \$230 per store on the first 233 stores selected [to list at],” (ibid.). To be part of The Beer Store, brewer’s pay upfront, then per SKU, then per store.

This particular sales channel has been a point of tension and controversy for Ontario craft brewers, since Brewers Retail is owned 49% by Molson-Coors, 49% by Anheuser-Busch InBev (Labatt), and 2% by Sapporo. This is an ownership structure that places sales of brewery product in the hands of three of the world’s largest brewers and the largest brewer in Canada. For many brewers, this especially sours the upfront fees paid to list their products as those fees directly or indirectly are to the benefit of The Beer Store’s owners, craft beer’s major competition. Further, the governance structure is similarly misrepresented, with only token attempts to include craft brewer’s voices. Brewer’s Retail board of directors includes five seats for Molson-Coors, five seats for AB InBev, two seats for Sapporo, two seats for large craft brewers, and finally one seat for a small craft brewer. The craft brewer’s seats were implemented in 2014 as a response to ownership and governance controversy, as this particular power structure gained media attention that year.

TBS claims to be a retail and distribution system “operating on a cost recovery basis,” which leads the layperson to believe that The Beer Store, as it is independently incorporated does not technically make any profit, which is the technicality that allows TBS to claim it is not a monopoly. Any profit above breaking even gets funneled to the owner breweries in the form of dividends. Sen (2013) found in a comparative economic study

with Quebec beer sales retail profits that TBS brings in \$700 million per year that is unaccounted for by expenses. Additionally, Beer Stores that are known to move high volume will charge double the listing fee to stock in those stores as they hold that discretion.

Beyond the high listing fees, another roadblock to craft brewers selling through TBS is a lack of access to merchandising. A brewery sales employee expressed frustration with the new computerized touch screen system, which is an inherently inefficient and non-user friendly system. TBS employees are prohibited from offering recommendations on product and merchandising in the beer store is intentionally prohibitive, because “The less information they provide you, the more profit they [the large breweries] make” (Interview, Erica Campbell, January 6, 2016).

This flawed system is presently undergoing some major shifts, however. TBS and the Government of Ontario are well aware of the inherent controversy that exists surrounding The Beer Store as craft breweries are the fastest growing segment. In April 2016, the Premier’s Advisory Council on Government Assets published a report entitled “Striking the Right Balance: Modernizing Beer Retailing in Ontario” which focuses largely on restructuring the ownership and governance of TBS under proposed “The New Beer Framework.”

While The New Beer Framework proposes that TBS begins to offer more merchandising opportunities for suppliers, the document does not outright detail what that means. It does set out that all TBS locations will be walk-in and open concept shelved by

the end of 2017, which is a great improvement from the mysterious back-end, alphabetically ordered wall sticker system.

In January 2015, TBS threw a bone to craft brewers offering small brewers no listing fee when stocking two new products at the five Beer Store locations closest to their brewery. The development as stated in The Beer Store's release to all suppliers is outlined below:

"Small Ontario brewers (those that sell fewer than 1 million litres/year at the Beer Store) will pay no listing fee when stocking two of their products at the five Beer Store locations closest to their brewery;

Beyond those five stores, small brewers will be able to list the same two products at any additional Beer Store location at reduced listing fees, paying only the per-store fee;

Small brewers have also asked for the ability to introduce seasonal brands throughout the year. Yesterday, the Beer Store announced the implementation of this change. Brewers can swap out a new or existing brand listing and replace it with a seasonal brand twice a year at no additional cost."

(Internal email, January 2015)

### *9.3 Liquor Control Board of Ontario*

The Liquor Control Board of Ontario (LCBO) was formed as a result of the Liquor Control Act in 1927. Following the prohibition era, the Ontario government sought to take control of alcohol sales and "subjected alcohol consumption to its disciplinary gaze," (Thompson & Genosko, 2009). The government organization has evolved throughout the years from being an alcohol consumption control organization that tracked consumption on an individual basis to the alcohol retail empire it is now. The LCBO is now one of the

largest buyers and retailers of alcohol in the world, due in large part to its monopoly status on selling spirits in Ontario. For craft brewers, one brewery owner interviewed for this paper referred to the organization as “a necessary evil” and another referred to them as “the gatekeepers.”

For brewers to sell through the LCBO, they must meet laboratory, packaging, labeling and bar code requirements. While there is a relatively low listing fee to sell through the LCBO, brewers are charged a fee of \$135 per product per year for annual lab testing on products that are not distributed through the warehousing system.

Brewers may conduct their dealings with the LCBO one of two ways. Larger brewers may elect to take advantage of the warehousing system, wherein alcohol manufacturers respond to company wide inventory requirements based on stock in the five LCBO warehouses. Theoretically, this system seems logistically simpler, as a brewer would only have to deliver to their nearest warehouse and the rest of the product movement and sales would be dealt with internally by the LCBO. However, a number of brewery employees interviewed for this paper reported the warehousing system to be frustrating and challenging. There are few craft breweries that still utilize the warehousing system as a large number found they were unable to keep up with its demands or maintain a beneficial sales relationship with individual stores. For example, under a warehousing system a brewery operating at three thousand hectolitres would receive a purchase order for four hundred to a thousand cases (anywhere between 100 to 500 hectolitres) from the LCBO and be expected to ship it the following day. For breweries that rent their canning or

bottling line, have not upgraded to more efficient packaging equipment, or do not have the production capacity to keep up, this requirement is difficult to meet.

The automated computer systems within the store are similarly not beneficial for the individual breweries. The warehousing system creates automatic minimums that prompt the individual store to order from the local warehouse. These minimums are quite low; in interview with Erica Campbell (January, 2016), she explained the warehouse computer system will prompt the store to restock the bare minimum of product to the shelf, which will often be one case at a time, when for merchandising purposes the brewery supplier would prefer to have a stack of five on the shelf at a time for the sake of visibility on the shelves. The solution for this issue from the brewery salesperson's perspective is to convince each individual store to raise their minimum for their product in their warehouse inventory system – an awkward discussion that few LCBO employees know how to address. Encouraging more shelf space for their product is similarly difficult. The warehousing system is marketed as cheaper for manufacturers, though its complications far outweigh its benefits.

By contrast, working on a direct delivery system has facilitated much easier relationships between craft breweries and the LCBO. To maintain a sales relationship with an LCBO involves telephone or in-person contact as email ordering is not an option. Each individual LCBO store has an allotted staff member as the go-to for each product category. The employee at any given store who deals with beer inventories is referred to as the Beer Ambassador<sup>26</sup>. These direct relationships with each store's Beer Ambassador, coupled with

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<sup>26</sup>“Many of them are beer geeks, but just as many don't care about beer at all. They can either be your most useful contact and make sales incredibly easy, or they don't,” explained Erica Campbell.

frequent deliveries by a brewery employee to each store allow the brewery to keep track of inventory and to cultivate business relationships with the people who deal with direct sales of their product. A hands-on sales approach also allows the brewery to ensure that their product is making it from the back stock section of the store to the shelf in front of house, a complication that is produced often by basic human error.

Dealing with the LCBO on an individual store basis allows for business relationships to operate on a relatively similar playing field. As one of the world's largest retailers of alcoholic beverages, the disparity in scale between craft breweries and the central LCBO does cause a number of predictable difficulties. As a Crown Corporation with a number of ingrained bureaucracies, foibles such as a misplaced invoice or a minor error can take months to fix and the LCBO does not hesitate to withhold payment to its suppliers while investigating an error. For a craft brewer this can mean cash is being withheld. "When there is a problem with the LCBO, it is really intense to fix. There is no phone number or direct contact to deal with your issue – there is an info email and you get the sense that things go into the ether," (Interview, Erica Campbell, January 6, 2016).

Navigating the LCBO's system is often referred to as a learned skill that a number of new breweries struggle with. The company's trade website, [www.doingbusinesswiththeLCBO.com](http://www.doingbusinesswiththeLCBO.com), is supposed to be the resource for all suppliers to the LCBO, though two interview subjects reported its content to be vague and impersonal, a description confirmed with a quick perusal of the website. A notable indicator of the type of online experience a supplier will have with the LCBO is the amount of online login usernames and passwords brewers are assigned. One craft brewing sales representative

claims to have three that she must remember to do her job. Gaining access to these logins can be difficult and delaying. Many breweries allot a full time staff member to navigate the LCBO sales channel as its demands can be meticulous.

For St Jacob's Block Three, the wait time for a product approval in the LCBO reportedly took longer than it should have, and this experience appears to be common for craft brewers. Frustrations stem from the length of time it can take for labels and packaging to gain approval, as well as the competition for shelf space as more craft brewers attempt to sell through the LCBO. To achieve a year round flagship brand on reliable offer in a high volume store is considered a great feat for craft brewers, though a number of seasonal brands are rejected due to the high volume of brewers offering similar seasonal styles. Further, many report<sup>27</sup> that the LCBO discriminates based on packaging: at present, tall cans are the preferred packaging being accepted by the LCBO, though this particular approach is expensive for brewers and offers low margins and requires the product to be sold at high enough volume to make it worth the brewer's while.

Overall, craft breweries interviewed for this paper reported a relatively positive relationship with the LCBO. The system has eased for small brewers through the last decade, with breweries such as Block Three maintaining a healthy business relationship with as few as twenty stores in their region, feeling limited pressure to expand to further stores. There is pressure to ensure product can sell itself, as the LCBO provides only basic promotional programming such as in store tastings and limited merchandising. Others argue that this pressure is normal and represents a level playing field. When a craft

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<sup>27</sup> Interview with Erica Campbell, Block Three, casual industry knowledge

brewery on direct delivery stocks out, there are no real consequences to the brewery aside from the frustration of specific stores waiting on product, though many breweries report a healthy back and forth relationship with their key LCBO stores regarding their growth. Beau's All Natural reported that, during an earlier growth phase, when they would stock out at LCBOs, they gave their LCBO stores an official Beau's letter to place on their shelf space to apologize to their customers and to give a timeline as to when the beer would be ready and delivered to that store, a personal touch LCBO employees were happy to oblige.

Further, the LCBO is known for paying its suppliers in a timely manner when protocol is followed. Arguably, the meticulous paper trail the LCBO requires of its suppliers, especially on direct delivery basis, is a great advantage for craft brewers to track their sales in a manner many small businesses struggle with. Compared with the reported frustrations of receiving payment from licensee establishments, as discussed below, this is a welcome offshoot of dealing with an organized, well-funded Crown Corporation.

Funding benefits extend as far as allowing LCBO stores to invest in basic renovations such as installing walk-in fridges for beer selection, a great boon to craft brewers that do not pasteurize their product. Selling through the LCBO allows brewers to ensure their product gets to customers, more often than not, in its intended state. Similarly, the LCBO is motivated to move product that has not sold. Beer that has been sitting on the shelf too long will be marked down based on its best before date, a contrast with anecdotes from the Quebec private sales channels, where small beer retail businesses will be hesitant to mark product down as they pay out of pocket for it, resulting in product sold at full price past its prime.



Merchandising with the LCBO is difficult and can be expensive should a brewer choose to buy into things like space in Food and Drink magazine, the LCBO's bi-monthly promotional publication or certain AirMiles partner programs. Much of the colourful branding of craft brewers in Ontario is due in large part to a need to differentiate in the face of limited merchandising opportunities on LCBO shelves. There is a sense that craft brewers in the LCBO struggle to find the perfect balance between offering eye catching labelling and remaining within the constraints imposed upon them by the LCBO (the LCBO is critical of any labelling that seems to promote unsavoury behaviour, or that makes drinking seem appealing to children). That said, the LCBO can on occasion be convinced on a case-by-case basis to move product to more visible parts of the store free of charge for the sake of visibility. Otherwise, the onus is on the brewery to invest in promotional programming for their product. Customer in-store tastings are an opportunity for brewers to set up a tasting bar for four hours during peak periods, though the brewer must pay the LCBO at retail price for each bottle or can of their product used during the tasting, as well as the cost of paying a staff member to conduct it. For product to be put on sale, the brewery must pay for the sale to happen unless it is a decision on the part of the LCBO store employees to move that product more quickly.

Some of the challenges craft brewers have had with the LCBO mirror those of small scale food producers working with large retailers, particularly in the difficulties of supply-chain logistics and consumer's expectations of constant availability (McCallum; Campbell; MacRae, 2014). As evidenced by Beau's story of apology letters placed on LCBO shelves, the LCBO's system, while convoluted has allowed for certain in-person relationships to be made between brewery sales representatives, store employees and consumers. It seems

that the LCBO's strategy of a captain for each product category has been quite useful to the brewers in that they have a direct contact at each store. Perhaps there are lessons that can be taken from these processes that could be applied in other large retailers looking to localize.

#### 9.4 Grocery Stores

Beer sales in grocery stores are a new phenomenon in Ontario, launched unexpectedly in early December 2015 when it first seemed slated for Spring 2017. Beer sales in grocery stores is technically still routed through the LCBO, with it acting as wholesaler of all beer products through their warehouse system.

The eligibility requirements for grocery stores to sell beer are:

"To be eligible to sell beer, each grocery store must meet a number of characteristics:

- Location sells a full line of food products;
- A minimum of 10,000 square feet of retail space is occupied by food products; and
- Location is not primarily considered a pharmacy.

As committed in the 2015 *Budget*, the Province has mandated in law requirements related to the socially responsible sale of alcohol, including:

- The sale of beer adheres to standard hours and beer is to be located in a single designated section of the store;
- Beer sold in grocery stores cannot exceed 7.1 per cent alcohol by volume;
- Beer will be sold in a six-packs or less, up to 750 mL per container" (Ontario Ministry of Finance, 2015)

As this sales channel is quite new, information gathered from interview subjects was speculative. The major feedback with regards to craft beer access was that if beer could only be sold in six pack formats, with the maximum alcohol content at 7.1% (most imperial IPAs – a common, strong India Pale Ale style - are at 8% ABV) and that it was exclusive to stores at minimum 10,000 square feet, which makes grocery stores a limited channel. The Ontario Government has committed to having four-hundred-and-fifty grocery stores selling beer. Three interview subjects described it as unfair that the system was not changing fast enough.

### *9.5 Bars, Pubs and Restaurant Licensees*

Arguably one of the cheapest options, many craft brewers build their brand by selling product through a local bar or restaurant. As discussed in Case Study 1: Beau's All Natural Brewing Co., the emerging network of independently owned bars and restaurants in the region allowed for the brewery to form direct relationships and to move product at a high volume, often in the cheapest container available to them: kegs. The casual nature of these relationships has stemmed from the fact that both businesses operate on a relatively similar scale, where business owners can form mutually beneficial business relationships. These sales relationships are especially easy when the culture of these establishments is in line with the culture of the brewery. Beau's has sought to create a niche, high end product with a locally focused narrative, which is mirrored in the small company culture of many of their major partner licensees.

Sales through small licensees are not necessarily always easy, however. A common complaint among brewery sales representatives<sup>28</sup> was that there are a number of licensee establishments that will not pay on time, or will withhold payment based on not having sufficient funds. This was cited as a major inefficiency in selling through the small business licensee network.

Large corporately-owned restaurants and pubs are a channel that craft breweries have found difficult to break into. Often, chain restaurants have many years of experience partnering with the large foreign-owned breweries, such as Molson-Coors and Labatt, and have come to expect to do business on that scale. For example, as outlined in the Block 3 case study, their owner expressed a major challenge regarding licensee sales as a small brewery given price undercutting by larger breweries. Molson-Coors, Labatt or Sleeman can afford to provide their licensees with free kegs, branded tables, umbrellas, tap handles and even fridges and tap lines with regularity, while a small craft brewery will often not have the resources to offer such perks.

In this section I have attempted to provide a detailed report of the sales channels available to craft brewers in Ontario, and what those business relationships commonly look like based on the research I have conducted. I believe a general understanding of what those business relationships look like and what limitations or capabilities craft brewers have within them is essential to business and policy analysis.

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<sup>28</sup> Interview subjects Erica Campbell & Kristin MacDonald; dates in appendix

## 10.0 Policy Analysis

The word to describe the policies and legislation that oversee the beer industry would be reactive. There is a sense that the beer industry has grown in spite of itself since the 1980s, with policies shifting to accommodate the gradually increasing lobby of craft brewers and their supporters.

Prior to 2006, legislation and taxation was written as though small scale brewers did not exist. Federal and provincial excise taxes on beer manufacturers had every brewing company, no matter the size, paying the same tax rate as the large, foreign-owned breweries per hectolitre produced, which came out to \$31.22 per hectolitre (Canada Revenue Agency, 2006). “They accounted for 21% of our net revenue – much more than our payroll. It made it really hard to get to profitability at a low volume” (Gary McMullen, November 2015). In 2006, the Federal Government altered federal excise tax rates for small brewers to a tiered system that had brewers at the smallest tier, 2,000 hectolitres and under paying a tenth of that rate at \$3.122 per hectolitre. It is worth noting that this was Beau’s All Natural’s first year of operations, and as such the brewery was able to reap the benefits of the new taxation system from the start.

Similarly, in July 2010 the Ontario Government introduced the Beer and Wine tax, which took the burden of shipment fees payable to the AGCO to a tax that was absorbed by the consumer. John Graham at Church-Key expressed “The tax change in 2010 is really a defining point in the industry, it was government telling us they wanted independent brewers around in the future.” Gary McMullen of Muskoka Brewery explained that “the decisions that [governments] made at our behest – because we were lobbying hard, obviously - [the tax changes] were fundamental to this industry getting to where it has

gotten to. For me it's a great public policy success in terms of making positive change for an industry and the impact its had in communities small and large throughout Canada.”

Most recently, the Provincial Budget in April 2015 laid out proposed frameworks specifically aimed at improving beer retailing in Ontario. The move was likely a political reaction to a media leak in December 2014 of a secret deal signed June 1<sup>st</sup>, 2000 between Brewers Retail Inc. and the LCBO, which laid out The Beer Store's exclusive rights to sell beer in large package formats such as the twelve and twenty-four pack, prohibited the LCBO from selling major beer brands to bars and restaurants, gave TBS exclusive rights to sell in that market, and mandated the LCBO to inform TBS if any new store was to open in a new community (LCBO; BRI, 2000).

From spring of 2014, polls showed that 87% of consumers were not aware of The Beer Store's ownership structure, and once informed, 68% disapproved and hoped to see change (Harrison, 2014). Investigation into this sweetheart deal for TBS, along with the rapidly growing craft beer market led, in 2015, to beer retailing being a particularly hot policy topic for the Liberal Government. John Graham at Church-Key felt that the highly publicized and rapidly implemented policy changes were to cover other controversial moves on the part of the Ontario Government, such as the sale of Hydro One.

An outline of the major proposals under the new policies can be found in the report *Striking the Right Balance: Modernizing Beer Retailing and Distribution in Ontario* dated April 16, 2015. The major new changes are detailed in the new Master Framework Agreement between Brewers Retail Inc., Labatt Brewing Company Limited, Molson Canada,

Sleeman Breweries Ltd., and the Crown, signed September 22 2015. The core issues being addressed with the initial report were:

- “ – how to materially enhance customer convenience, choice and shopping experience, while continuing to ensure that Ontarians can buy their beer at prices below the Canadian average; and
- How best to establish a level playing field for all producers selling beer in Ontario”

The major components of these new policies affecting craft brewers are as follows:

- Opening ownership of The Beer Store to all brewers with facilities on Ontario; allowing four independent (brewery owner) directors on the board with effective veto rights on brewer fairness and “other important issues”
- Introduction of the Beer Ombudsman to promote accountability in TBS operations
- The introduction of “New Private Retail Outlets” (grocery stores) as a sales channel, which took effect in December 2015
- Minimum 20% in TBS and grocery stores, as well as costs of retailing through the TBS declining by a promised 5% to 10%
- Pooled deliveries by small scale brewers to retail points of sale and licensees, added option of utilizing third party carriers and warehousing
- The allowance for brewers to have a second on-site retail store if they have two brewing locations

- The June 2000 agreement entitled Serving Ontario Beer Consumers — Framework for Improved Co-operation and Planning Between the LCBO and BRI was dismantled

(Master Framework Agreement, 2015)

### *10.1 Policy at Work*

An interesting note in light of the introduction of these new policies is that brewers interviewed for this paper were unsure of the origins of the regulation regarding co-delivering beer with other craft brewers or utilizing a third-party system. Most were relatively sure it was illegal (though unable to identify what specific part of the legislation actually prohibited this type of activity), and have been functioning under the impression that their actions might be against the rules.

#### **Pooled delivery for small brewers**

In order to help small brewers manage costs and grow their businesses, the New Beer Framework will permit them to jointly deliver their products to the LCBO and to licenced establishments. Use of third party carriers and warehousing will also be allowed under the authority of the LCBO. This initiative will also benefit the licensees and retail channels themselves, as it will reduce the number of deliveries they each have to accept. (from <https://www.ontario.ca/page/modernizing-beer-retailing-and-distribution>)



At Block Three, owners felt that it was unfair that TBS had access to its own network of distribution services while craft brewers needed to use only their own trucks and staff. At Church-Key Brewing, John Graham noted that pooling deliveries “was illegal... from the prohibition repeal era when TBS was granted exclusive rights to it.” Interestingly, an actual piece of legislation that limits delivery and distribution rights to point of sale locations to The Beer Store and the LCBO does not exist. The rule was selectively enforced and third-party companies that have performed this service would have had to become bonded through the AGCO, meaning exceptions were made to this policy. Beau’s All Natural, for example has been using RG Transfer, a third-party delivery and warehousing company, for a number of years.<sup>29</sup>

In fact, the policy that prevented pooled and third-party deliveries previously is quite difficult to find (Appendix III).<sup>30</sup> The policy says that before October 2015, small brewers could only use their own delivery fleet or TBS delivery and warehousing services. The website [www.doingbusinesswiththeLCBO.com](http://www.doingbusinesswiththeLCBO.com) which brewery owners and staff are directed to as a resource for these policies, did not outright list the policy. The actual piece of legislation that exists in the Liquor Control Act 1990, which grants the LCBO control over the sale, transport and delivery of liquor, Section 3.1 b and c reads:

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<sup>29</sup> I tried to contact the owner of RG Transfer for this paper to ask him how he was granted exception, but he was unavailable. I was given this contact through John Graham, who is friends with the Beauchesne’s since the industry is very tight knit. According to Graham, the Beauchesne’s, Graham, and many other craft brewers in the region widely understood this practice was probably illegal. There are also a number of casual stories about small brewers not interviewed for this story pooling deliveries to farther reaches of the Province such as the Windsor area.

<sup>30</sup> I learned this after contacting the Ontario Ministry of Finance, who then worked with their contacts at the LCBO to locate the original policy which took two weeks and was a photocopy of a document from the 1990s. It can be found in the appendix.

“Power and purposes of Board

3. (1) The purposes of the Board are, and it has power,

- (a) to buy, import and have in its possession for sale, and to sell, liquor and other products containing alcohol and non-alcoholic beverages;
- (b) to control the sale, transportation and delivery of liquor;
- (c) to make provision for the maintenance of warehouses for liquor and to control the keeping in and delivery from any such warehouses;

Liquor Control Act, R.S.O. 1990 c. L. 18. <

<https://www.ontario.ca/laws/statute/90l18#BK5>>

The Ontario budget released in April 2015 outlines that “small brewers will gain the ability to more efficiently deliver their products directly to retail points of sale and licensees by pooling their products with the option of using third-party carriers and warehousing.” “... consistent with current policies concerning deliveries to existing retail points of sale (but without limiting the Province’s ability to allow other distribution to these new retail outlets), Ontario brewers licensed by the Regulator will be permitted to distribute beer directly to these new retail outlets either individually or collectively through TBS or as may be otherwise permitted.” Some brewers thought that this was a policy of the AGCO, others, as stated above, were under the impression that this was a prohibition era exclusivity deal for TBS. It was simply an LCBO policy that was not listed anywhere accessible. That new legislation would offer pooled deliveries to small brewers as though it were never practiced before speaks to the murky political regulatory environment small brewers have historically functioned under and the knowledge gap that exists between brewers and the laws that govern them.

Similarly, brewer’s on-site retail locations have been legally able to open and sell at 9am since April 2015, and most brewers are unaware of this as that new regulation under

the AGCO was passed quietly with very little outreach (Interview, John Graham, December 15, 2015).

Beau's has been something of a pioneer in civil disobedience of provincial brewery policies. In 2011 the company created the BYO Beau's program, a home delivery service of Beau's beer, administered by Beau's to those in the Ottawa area. The delivery service was originally halted in December 2011 for contravening the Liquor Licence Act that delivery services must purchase directly from the LCBO or The Beer Store. Beau's claimed ignorance to the policy and the Province of Ontario granted exemption from this rule relatively quickly. The company utilized an Ottawa area social enterprise to hire homeless persons as drivers for the initiative, and this charitable component likely made it difficult for the Province to shut it down. Following this move, the AGCO issued a bulletin announcing the change in these policies (AGCO, Info Bulletin no. 9028, 2011).

### *10.2 New Retail Channels & the Future of TBS*

An interesting discussion in light of the new grocery store sales channel is what implications new policies have on the future of The Beer Store. With the knowledge that the Liberal Government had previously entered into a "secret" deal with TBS, it is difficult to imagine the Province fully removing authority from the three major foreign-owned corporations. With the major retail corporate interests backing them, small brewer's numbers did not add up to be as powerful of a lobby group. Loblaw Companies Ltd. wanted a locally-based voice to rival those of Molson-Coors, Labatt and Sleeman at the bargaining table. It will be interesting to assess policy decisions that seem to give preference to one

interest over the other, i.e. large grocery retailers versus the three major owners of TBS, as it may reveal where the Province is placing priority, that is whether the Province sees wealth generation opportunities from within the Province or from foreign-owned interests. The recent announcement that Ontario craft ciders and wines would be available at grocery retail (Ontario News Release, February 18, 2016) seems to suggest the former. Loblaw Companies Ltd. has already made public a statement regarding its intention to stock more Ontario craft options than the necessary 20% of shelf space<sup>31</sup>, and appears to be the major grocery retailer opting for this market. Similarly, these “new retail channels shall be limited to 450 new retail outlets” (Master Framework Agreement, 6.5 (b)), a number that is curiously close to the 447 TBS retail outlets (The Beer Store, 2015). There is some speculation<sup>32</sup> that the Province has intentions to effectively “replace” TBS by working with Ontario-owned grocery retailers. However, it is unlikely that TBS will ever truly go obsolete: its distribution network and consumer recycling resources are much too developed to dispose of. It is likely that TBS will maintain its position as sole retailer of high volume packaged beer such as twenty-four packs of commodity lagers – which is a place in the market that it does not seem any craft brewers are seeking to obtain – while grocery stores will stock smaller package formats.

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<sup>31</sup> In a press release issued December 15<sup>th</sup>, the first day of grocery store sales for beer. As well, the ribbon cutting ceremony with the Premier occurred at a Toronto area Loblaws store, and Loblaw Companies Ltd. stores have been the first with beer sections fully stocked.

<sup>32</sup> Among some members of the craft beer industry, casual knowledge.

## 11.0 Conclusions & Future Directions

The experiences of four Ontario craft brewers functioning under the current frameworks reveal a number of key themes. First, barriers to market entry for small brewing entrepreneurs are lower than ever, with available sales channels expanding, tiered tax rates, ease of access to traditional start-up capital, and a growing market of customers with a developed taste for different beer styles. This research has revealed, unsurprisingly, that entrepreneurs with a well laid-out and disciplined business plan are likely to succeed in this industry.

Secondly, a major motivating factor and a key to success has been the passion and work ethic of small brewery owners. Without the early pioneer's efforts, extra-curricular government lobbying, and organized formation of the Ontario Craft Brewers Association, the industry would likely not be where it is today.

Third, the discussion of ownership, authenticity and responsible growth is a particularly topical one among craft brewers. Each brewery interviewed noted the "fake craft" brands owned by macro brewers are a major challenge. They also seek to keep the craft beer industry as convivial, genuine and cooperative as it currently is, which are traits they feel are lost on many business sectors. Further, each brewer independently commented on their wish to grow responsibly; remain somewhat niche, but be widely respected. This is consistent with resource partitioning theory (Swaminathan, 2000), where the market has one or two major players supplying the market with a general product and a larger number of smaller players offering differentiated niche products that cannot be provided by the large companies.

The conscious desire to avoid growing too big is in line with many principles of the Green Economy and low-growth economics (Victor, 2008; Jackson, 2009). Many brewers expressed sentiments of feeling overshadowed by their competitor macro brewers and are highly critical of those brewers' foreign ownership and of companies growing so large. They strongly believe in local economic development and see themselves as leaders in their communities.

Fourth, small Ontario brewers have commonly struggled with the retail sales channels available to them, whether this has been due to bureaucratic inefficiencies on the part of Crown Corporations, or cost barriers and the ownership structure associated with TBS.

Fifth, navigating Provincial policies for Ontario craft brewers has historically been difficult, riddled with red tape and favouring the macro brewers. There is a particular sense among the craft beer industry that Ontario alcoholic beverage retailing policies are working against them, even when major strides are made to rectify some of the most pressing issues. Many craft brewers hold a distrust of government motives and, more than that, hold a sentiment that policies are written for larger companies with economies of scale and largely neglect to address SMEs. Many policies began to change in 2015, but the effect of them, as well as the business practices and relationships they have the potential to influence, remains to be seen.

Sixth, the availability of alternative marketing techniques and information sharing has been a great boon to these brewers, confirming the findings of Clemons et al. (2006). By foregoing traditional marketing costs and instead taking advantage of inexpensive social

media and word-of-mouth strategies, brewers have been able to carve out their niches and create brand awareness quite effectively.

Seventh, with regards to sustainable business practices in the sector, these four SMEs reported that in many cases, sustainable business practices were synonymous with savings, including reducing water use, capturing excess heat from refrigeration and reducing waste. Taking a mindful approach to sustainability, considering each angle and doing as much as possible was part of each brewery's strategy. The businesses studied here confirmed that brewery SMEs can successfully utilize sustainability in their business strategies and practices as well as remain flexible. Of the breweries I interviewed, two brewery owners had a deep and profound understanding of sustainability and brought that to their business practices; the other two held the best of intentions, though sustainability was seen as either a bonus or an afterthought.

Finally, the industry is unique in its camaraderie and sense of community. That Ontario craft brewers see each other not as competition but as colleagues and often friends is some evidence that the diversity of the craft brewing network is working. The locally-focused sales and marketing strategies of these breweries seems to suggest that there is enough market competition that brewers remain on a level playing field and on good terms with each other.

### *11.1 Future Directions*

Given all of this information, the major questions to the future of the industry as I understand them are:

- What more can the Ontario Government do to cultivate diversity and maintain the strength of the brewery SME network in the economy?
- How best can the “level playing field” be improved and then maintained?
- What can be done to protect the concept of “craft” and ensure the “market correction” of craft products is maintained? Can we avoid market consolidation in the wake of craft brewery acquisitions by macro brewers?

First, the Ontario Government could provide legal definition to “craft brewing.” At present, the Liquor Control Act defines a “small” brewer as “production did not exceed 400,000 hectolitres of beer” in the past year (Liquor Control Act, R.S.O. 1990). The definition of craft as provided by the Ontario Craft Brewers Association is loose enough that it allows for growth up to that size, which is quite significant, but accounts for the basic need for “traditional” ingredients as well as independent ownership. The Liquor Control Act could be revised to include more specific industry concepts to protect the definition of craft and encourage entrepreneurship.

Second, at present, there are no legal requirements for manufacturers of alcoholic beverages to list ingredients or nutritional information on their labels. As a result, many craft brewers have taken advantage of this omission in the legal system to proudly display their short, traditional ingredients lists. In making ingredients labelling a legal requirement for all brewers, I believe consumers would be more inclined to purchase true craft beers as



they contain no adjuncts (i.e. rice, corn), while their fake craft competitors would be forced to list their adjuncts.

Ontario is at a pivotal moment regarding The Beer Store and other retail sales channels. As stated in the analysis section, there is speculation that grocery stores may be slated to, in effect, replace TBS as the major retail sales channel. Moving in this direction appears to be responsible on the part of the Province, as it takes this piece of the market away from foreign-owned breweries and places that chunk of the market in the hands of large grocery retailers – some locally-owned, and some, like Loblaw Companies Ltd. are foreign-owned. Either way, more high-profile stakeholders in the sale of beer allows for a more diverse playing field than previously existed. If this is the case, The Beer Store could theoretically continue to be the major retailer of high volume packaged beer and discount brands, which may be an ideal place in the market for TBS and its extensive distribution network. While the relationships between small-scale brewers and large grocery retailers may cause friction as seen with the LCBO, there can easily be store-based systems in place to make those relationships easier, much like the Beer Ambassadors at the individual LCBO stores.

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## Appendix I: Interview Guide

*For owners, presidents, CEOs*

Start up:

- Can you tell me a bit about how you started this company?
- What were your biggest start-up challenges?
- Where did your start-up capital come from?
- What were your biggest assets? How did you acquire them?
- How did you scale your business? What were your investment priorities?

Current:

- What are your three biggest challenges currently?
- What is your greatest operational expense?
- What do you wish you had more resources to do?
- To what do you primarily attribute to your brewery's success?
- What are the factors you feel draw people to your product?

Food Industry etc.:

- How do you integrate into your local community?
- Do you source your ingredients locally?
- What is your stance on the local food movement?
- How do you feel the local buying local trend has affected your business?
- Has the Ontario craft beer industry's growth had any effects, good or bad, on your business?
- What do you attribute the current growth of the industry to?
- What do you see as the industry's greatest weaknesses?

- How do you feel about standardization in terms of waste reduction? i.e. bottling standardization for more recycling, etc?
- How do you integrate sustainability into your business practices? What are the motivations?

### *Staff Questions*

- How long have you worked for Beau's?
- What is your role there? Purchasing Manager
- How did you come to work for the company?
- What were you doing before?
- Did you relocate to work for Beau's? If so, from where?
- Do you have specific training or educational background for the role you perform at Beau's?
- Describe what your role entails and your day-to-day at work:
- Do you feel your role is impactful? (this can mean for the company, or even for the world at large if you want to think on a macro scale)
- Do you feel there is anything unique to your position specific to Beau's? (i.e. how does it look different or similar to being purchasing manager at any other company?)
- Do you feel you are compensated adequately and/or within an industry norm for your role?
- Do you see your long-term career in the craft beer industry (or at Beau's specifically)?
- How would you describe Beau's All Natural Brewing Co. as an employer?
- Do you note anything specific about working in craft beer vs. other industries? Are there any perks/trade offs?

## Appendix II: Labbatt Connections Brief on fake craft marketing



## CONNECTIONS BRIEF

09-16-14

Project	Shock Top 2015 IMC: Fun Craft Connection	Date: September 17, 2014
<b>Why do we want new advertising?</b>		
<p><u>Shock Top is Labatt's big bet in the battle against Micro Craft.</u> Micro Craft is growing rapidly, with the proliferation of brands eroding Labatt's share. These tiny powerhouses are strong regionally, winning through local craft connection models (local footprint, experiential, non-traditional).</p> <p>While Micro Craft is a strong opponent, Shock Top has the small brewer/ craft credentials to compete, and the resources to win and change the game in the fragmented craft segment. We captured our target's attention with the validated "Speaks for itself" campaign. Now we need a significant transformation to redefine flavour in craft with our delicious, approachable liquid, and cement Shock Top's position as a fun, flavourful craft brand.</p> <p><b>Problem:</b> Shock Top needs to grow volume by 40% in 2015 (macro volume), while maintaining micro / craft credentials.</p> <p><b>What we want:</b> A disruptive local craft connection plan that delivers on "flavoursome taste, to drive Shock Top penetration with Experience Maximizers in the "Reward Myself" need state.</p> <p><b>Objectives</b></p> <ul style="list-style-type: none"> <li>• <b>Volume:</b> Grow volume by 40% in 2015</li> <li>• <b>Penetration:</b> Drive P4W from 0.6 (2014) to 1.0 (2015)</li> <li>• <b>Imagery:</b> Statistical increase on "flavoursome taste"; maintain "is from a small brewer"</li> </ul>		
<b>Who are We Talking To?</b> Matt		
<b>Consumer Insight:</b> I like to reward myself by trying different, flavourful beers, but I'm intimidated by most craft beers because they're too pretentious and complicated.		
<b>Brand Ideal:</b> Shock Top exists to inspire people to "live a life a full of flavour".		
<b>Think:</b> Shock Top is a fun, flavourful craft beer.		
<b>Feel:</b> Shock Top lightens my mood and makes me feel carefree.		
<b>Do:</b> Try Shock Top.		
<b>They should believe it because:</b>		
<ul style="list-style-type: none"> <li>• Unfiltered Belgian style wheat beer, with hints of citrus and coriander</li> <li>• Performs against 'reward myself' &amp; 'craft' purchase drivers: refreshing, easy to drink, fun to drink, flavoursome taste</li> <li>• The surprisingly refreshing taste of a wheat beer full of flavour</li> <li>• Shock Top has craft credentials: 75 % of consumers believe Shock Top is from a small / unknown brewer</li> <li>• A family of flavourful variants (Belgian White, Chocolate, Raspberry White, Lemon Shandy, Spiced Pumpkin)</li> </ul>		
<b>Mandatories</b>		
<ul style="list-style-type: none"> <li>• Local craft connection model - always on, with Q2 focus. <ul style="list-style-type: none"> <li>- Hero: Belgian White</li> <li>- Anchored in functional benefits (i.e. unfiltered)</li> <li>- Include XM / festival plan</li> </ul> </li> </ul>		
<b>Considerations</b>		
<ul style="list-style-type: none"> <li>• How do we tactically activate Shock Top around new drinking occasions (2-3 trade periods per year, i.e. Halloween)? <ul style="list-style-type: none"> <li>- Consider if we focus on Belgian White, flavour variants, or family (open to range of options)</li> <li>- Seasonal variant cadence: Winter - Chocolate; Summer - Lemon Shandy; Fall - Spiced Pumpkin</li> </ul> </li> <li>• Incorporate a serving ritual</li> </ul>		
<b>Budget:</b> \$2.7MM all in (media 1.5MM, XM 0.7MM, production 0.5MM) + trade \$1.1MM (retail 1MM, on premise 0.1MM)		
<b>Timing:</b> Brief Sept 17; Tissue w/o Sept 29; IMC Presentation TBD; Validated connection plan Dec 12; In market 2015		
<b>Who decides:</b> Brand - [REDACTED]; Trade - [REDACTED]		

## Appendix III: Original LCBO policy regarding pooled deliveries for small brewers.

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### MINISTRY OF CONSUMER AND COMMERCIAL RELATIONS/ LIQUOR CONTROL BOARD OF ONTARIO

#### LICENSEE DELIVERY

##### *Policy Objective*

To separate activities between individual brewers and licensees.

##### *Policy Rationale*

To prevent brewers from providing inducements to licensees, brewers will not be allowed to deliver directly to licensees.

##### *1. Delivery to Licensees*

As part of the service provided to all brewers who list exclusively in BRI, the BRI delivery system will deliver directly to licensees. If beer is sold in both BRI and LCBO, beer will be delivered by the BRI, or a licensee can pick-up the beer at a BRI store.

For beer only sold in the LCBO, the LCBO will be responsible for arranging the delivery of all beer to licensees. Licensees can also arrange for their own pick-up and delivery of beer sold only in the LCBO. In either case, the licensee is responsible for the cost of delivery to his premises.

##### *2. Cottage Breweries*

An exception will be made to cottage breweries, defined as breweries under \* 25,000 hectoliters, which will be allowed to deliver packaged and draught directly to licensees.

This exception may be withdrawn at any time if a brewer is found guilty of violating the *Liquor License Act* and its regulations pertaining to inducements.

##### *Policy Rationale*

An exception is made for cottage breweries who as a rule sell non-pasteurized beer which require special handling requirements.

\* changed to 75,000

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