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Ontario Lowers Wholesale Markup on Cannabis

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Effective September 11, 2023, the Ontario Cannabis Store (the OCS) will lower its wholesale markup, in an effort to "support a vibrant cannabis marketplace that helps to displace illegal operators."[1]

Background

The OCS is the only legal cannabis wholesaler in Ontario. Entities that are licensed by Health Canada to cultivate or process cannabis (generally known as LPs) are only allowed to sell recreational cannabis in Ontario to the OCS. Authorized retailers in Ontario are also only allowed to buy from the OCS. Therefore, the OCS has significant control over the cannabis supply chain. The OCS is also one of the biggest competitors to retailers, as it sells cannabis on OCS.ca, where it offers free delivery.

Part of the mandate of the OCS is to "enable a retail system that will combat the illegal market."[2] However, the illicit market still accounts for more than 40% of cannabis sales in Ontario,[3] despite more than 1,500 cannabis stores operating in the province.[4]

Much of the illicit market's success results from relatively high prices in legal stores despite the average price per gram of cannabis in Ontario being reduced from $11.78 to $7.50 from 2019 to 2021.[5] Currently, Ontario consumers pay $1 per gram in excise tax, an average OCS wholesale markup of 31%, plus an additional 13% HST.[6] All of these government taxes and provincial markups represent approximately 47% of the basket price of legal cannabis (when purchasing in one-gram quantities).[7]

Lowering the Wholesale Markup

On September 11, 2023, the OCS will move to a fixed wholesale markup on all its products. As a result, the markup on dried flower and pre-rolls will be 8% and 2% lower, respectively. The OCS will also impose a wholesale cost floor of approximately $2.28 per gram for dried flower and pre-rolls.[8]

Further, the OCS is changing its direct-to-consumer markups on OCS.ca. The OCS will apply a fixed 39% markup (on top of the wholesale price) on its website.[9]

Supply Chain Implications

David Lobo, President & CEO of the OCS, said that the lower markup is expected to contribute approximately $60 million annually to the marketplace.[10] However, it is unclear whether LPs, retailers, or consumers will experience the majority of the cost savings. If LPs raise their prices, the only way retailers will benefit from the lower markup is if they also raise their prices – which would benefit the illicit market, thereby undermining the OCS's mandate.

It is also unclear how much the fixed, 39%, e-commerce markup will help retailers compete with OCS.ca. During FY2022 (ending March 31, 2023), Ontario experienced retail cannabis sales of $1,519,460,000.[11] $72,700,000 of this was from OCS.ca, representing approximately 5% market share.[12] The OCS already profits greatly from its wholesale channel ($1,107,800,000 in FY2022) and does not need to bolster profits with the retail channel.[13]

Bottom Line

The wholesale markup reduction helps foster better conditions for all stakeholders – but it is unclear who the primary beneficiaries will be. In any event, in an industry that requires regulatory attention and reform, it is a positive development to see the Ontario Government starting to take notice.

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[1] https://ocs.ca/blogs/news/ocs-announces-upcoming-changes-to-pricing-structure

[2] https://www.doingbusinesswithocs.ca/wp-content/uploads/2022/04/OCS-22-25-Business-Plan-ENG_F.pdf

[3] https://www.cbc.ca/news/canada/toronto/ontario-cannabis-pricing-wholesale-retail-1.6921175

[4] https://www.theglobeandmail.com/business/article-ontario-retail-cannabis-stores/

[5] https://www.cbc.ca/news/canada/toronto/ontario-cannabis-prices-marijuana-1.6750832#:~:text=producers%20getting%20squeezed-,The%20average%20price%20for%20cannabis%20was%20%2411.78%20per%20gram%20at,firms%20Hifyre%20and%20BDSA%20said

[6] https://www.cbc.ca/news/canada/toronto/ontario-cannabis-pricing-wholesale-retail-1.6921175

[7] https://stratcann.com/wp-content/uploads/2022/05/Cannabis-Council-of-Canada-Economic-Analysis-of-Cannabis-Excise-Duties-Mark-Ups-and-Regulatory-Fees.pdf

[8] https://learn.ocswholesale.ca/wp-content/uploads/2023/06/OCS-Pricing-Updates.pdf

[9] https://learn.ocswholesale.ca/wp-content/uploads/2023/06/OCS-Pricing-Updates.pdf

[10] https://www.cbc.ca/news/canada/toronto/ontario-cannabis-pricing-wholesale-retail-1.6921175

[11] https://www.statista.com/statistics/1045847/cannabis-store-sales-ontario/#:~:text=Monthly%20retail%20sales%20of%20legal%20cannabis%20stores%20in%20Ontario%202018%2D2022&text=Since%20the%20federal%20legalization%20of,Canadian%20dollars%20in%20December%202022

[12] https://www.doingbusinesswithocs.ca/wp-content/uploads/2022/12/OCS-2021-22-Annual-Report_F.pdf

[13] https://www.doingbusinesswithocs.ca/wp-content/uploads/2022/12/OCS-2021-22-Annual-Report_F.pdf

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