Retail industry highlights
Cannabis retailing
A look at the cannabis industry post-legalization
Retailing cannabis
Industry insights

The world has watched Canada become the world’s first developed country to legalize recreational cannabis nationwide.

Establishing this new retail industry has many implications. The public and private sectors have had to work together to answer important questions such as: What does a legal market look like? How do we stand up retail and distribution of this new product? How do industry players support each other to ensure product quality and integrity? Who are the target customers, and how do we provide a superior customer experience?

While cannabis is a regulated product, retail fundamentals still apply: differentiate from the competitors, provide a superior customer experience, and win in this budding marketplace.

To understand how recreational cannabis retailing in Canada has performed to date, Deloitte recently interviewed licensed producers, manufacturers/brands, industry leaders and professionals to gather their perspectives on the trends and challenges in the retail cannabis space.
Overview

Trending positively

- **Product assortment**
  Ongoing improvements cater to customer demand

- **Customer experience**
  Retailers continue to strive to deliver on experience

- **Education and safety**
  Pre-legalization concerns have not materialized

- **Industry investment**
  Cannabis is attracting talent from across the retail industry

- **Demographics and data**
  Cannabis appeals to a broad customer base

Work in progress

- **Illicit market**
  Customers need more reason to convert

- **Regulations**
  Strict rules create retailing challenges

- **Overpromising**
  Overly optimistic promises lead to disappointment

- **Pricing**
  Competition with the illicit market remains stiff

- **Specialization**
  Vertical integration may not be optimal
What’s trending positively in this sector?
Product assortment
Ongoing improvements cater to customer demand

Customer experience
Retailers continue to strive to deliver on experience

Education and safety
Pre-legalization concerns have not materialized

Industry investment
Cannabis is attracting talent from across the retail industry

Demographics & Data
Cannabis appeals to a broad customer base
Trending positively

Product assortment

**Ongoing improvements cater to customer demand**

Cannabis retailers are monitoring consumer demand to identify the optimal assortment. While the industry is still evolving, retailers are striving to keep up-to-date on trends, innovations, and new product categories knowing that 1 in 3 cannabis customers cite unique new cannabis products as a key purchase driver.¹

The industry professionals we interviewed expect the excitement over edibles, concentrates, and topicals will decrease flower market share as customers lean toward these new cannabis products. Having a large and diverse product offering, as well as offering smaller units, will be key.

However, product breadth should not come at the expense of product depth, as this may lead to product stockouts for highly valued items or choice overload for consumers.

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¹ Deloitte
Product availability is starting to improve. Although producers remain focused on dried flowers because of their margins, customers want more value-add products, such as oils.”

—Cannabis marketing expert

Introducing more varied product ranges beyond dried flowers is important ... the more we introduce “vape-able” concentrates, topicals, edibles, the further flowers’ share will decrease.”

—Licensed producer

Although product assortment has increased significantly, no one retailer has a broad enough assortment yet to carve out their own niche.”

—Provincial liquor board
Retailers continue to strive to deliver on experience

Retailers have found unique ways to cater to customer needs and provide an engaging experience. For example, some retailers pair each customer with a “budtender” for the duration of the client’s shop. Retailers have also used unique channels, including social media sites, to collect customer feedback and adapt based on the responses.

Ensuring customers are able to make informed decisions about the products they’re seeking (e.g., by filtering for THC content or product functions) is becoming the standard for service. Although industry players have been nimble and able to adapt easily to cater to customers, the market is ripe for a truly customer-centric player.
" Consumers are hand-held. There are enough staff that you can have their attention for 30 minutes [to] yourself."

—Licensed producer

" It's fascinating to see the decisions retailers have made for their store operations."

—Provincial cannabis board

" The industry is really agile—the freeze on retail licences has helped retailers to continuously pivot. Retailers have been able to create processes to listen to customer feedback."

—Licensed producer
Trending positively
Education and safety

Pre-legalization concerns have not materialized

Many of the safety concerns regarding cannabis have not been realized. Since legalization, there has not been a significant increase in cannabis-related incidents, such as driving under the influence or more young people accessing cannabis. There have also been few product recalls, and when they did occur, the reverse logistics process has been reasonably quick and efficient.

Industry stakeholders have implemented effective messaging about social responsibility. To maintain this success, they should continue to educate consumers about safe consumption.

Retailers, for their part, must continuously ensure their sales associates are up-to-date on products and regulations. Because there is so much information about cannabis on the internet, of which so much may be contradictory and/or inaccurate, the information retailers provide to customers in-store and through other purchasing methods must be consistent and accurate.
“The government has executed legalization well—in terms of public health and safety, we haven’t had any issues. Recalls and the vendor reverse [logistics] process have worked well.”

—Licensed producer

“The intentions of all the heavy regulations are working. There hasn’t been evidence of increased amounts of driving high, minors using cannabis, or product recalls since legalization.”

—Provincial liquor board
Cannabis is attracting talent from across the retail industry

The Canadian cannabis culture is powerful. It has drawn together industry members with expertise in different retail backgrounds—analytics, category management, strategy, and more—to build and launch this brand new retail sector. The calibre of individuals entering this space is excellent, and industry professionals have strong relationships with one another.

The world is looking to Canada to learn and take advantage of insights from these industry leaders, because we are seen as pioneers in this space.

There is also significant financial support and investment across the industry, from Canadian firms expanding internationally to investments into new product categories (edibles and beverages, for example), and large retailers entering the sector. This excitement will continue to attract both talent and investment to the cannabis industry.
“No one comes from this industry, so everyone has used their past experiences to come together. The culture of the industry is powerful; the calibre of individuals is strong, and industry professionals have strong relationships with one another.”

—Cannabis industry leader

“There is a lot of financial support and investment in this industry, with a strong workforce and talent entering this space.”

—Cannabis marketing expert
Trending positively
Demographics and data

Cannabis appeals to a broad customer base

Although it’s often assumed that younger people are this segment’s target market, the age range and personalities of consumers in this space are excitingly varied. Those we interviewed said older consumers also want to talk about and experiment with cannabis. Industry players must continue to be aware of and welcome these dynamics to cater to a diverse consumer group.

This underscores the importance of capitalizing on data to best serve this new industry, whether it’s optimizing product assortment, inventory management, pricing, or customer experience. While current data may be skewed because it represents what customers say they “would do,” as this retail industry matures, a repository of data will be gathered based on actual consumer behaviour. Customer willingness to share data is expected to increase as well.
"There is a wide age range of consumers in this space. Older people want to talk about and experiment with cannabis, be it a re-engaged user or a curious user."

—Provincial liquor board

"A lot of people have thought from the outset that this is a large data play. What’s needed is history; a lot of the current data is influenced by trial and absence of reliable supply and choice. Customer research is based on what customers say they ‘would do.’ It needs time, but one day we will be able to collect good, accurate data."

—Provincial cannabis board
What is still a work in progress in this sector?
Illicit market
Customers need more reason to convert

Regulations
Strict rules create retailing challenges

Overpromising
Overly optimistic promises lead to disappointment

Pricing
Competition with the illicit market remains stiff

Specialization
Vertical integration may not be optimal
Work in progress
Illicit market

Customers need more reason to convert

Despite efforts to erode the illegal market, it continues to thrive due to product quality, loyalty, convenience, and price. While licensed producers have the benefit of larger facilities, the scale of production can sometimes negatively affect product quality. Product delivery also lacks compared to the illicit market, as many retailers continue to experience in-store stockouts.

The influence and creativity of the illicit market must not be underestimated, as it will continue to innovate. Within the first three months of 2019, only 47 percent of cannabis users purchased from legal sources.¹ Opportunities to drain the illicit market lie in competitive pricing, customer experience, micro-cultivation and niche plant genetics, and introducing unique channels (e.g., smoke lounges).

¹ StatsCan National Cannabis Survey 2019
“If one part of the mandate was to convert as much of the illicit market as possible, we’ve done a poor job.”
—Provincial liquor board

“It’ll be another five years before we have eroded the illicit market in a significant way.”
—Licensed producer

“As of now, eroding the illicit market is an uncoordinated effort. This has to be collaborative.”
—Provincial liquor board
Work in progress

Regulations

Strict rules create retailing challenges

Strict regulations on communication strategies have prevented retailers from providing comprehensive product information to consumers. This has made the purchasing experience especially difficult for beginner users, who lack knowledge about the differences between products and their effects. If they had increased flexibility to responsibly communicate and market products, retailers and licensed producers could more effectively educate consumers to help them make more informed purchasing decisions.

Challenges with regulations are expected to continue as we move into the next phase of legalization: edibles. The legal dose for packaged edibles has been set at 10mg per selling unit. This is far less than what is sold in the illicit market.
“If we were able to responsibly market the difference between products to customers, the customer experience would be better.”

—Provincial liquor board

“Regulations make it difficult for people to trust brands. Branding and marketing are very regulated, and storytelling is highly restricted.”

—Cannabis marketing expert
Work in progress

Overpromising

Overly optimistic promises lead to disappointment

Overpromising in areas like launch dates, product variety and formats, inventory levels, and supply can set the stage for disappointment. With the level of uncertainty that currently exists in this new industry, companies must ensure they are communicating realistic expectations to consumers, which will also help set a precedent for consistency and trust.

The availability of product is improving, but licensed producers are not able to package it fast enough. Fill rates continue to be unpredictable; typically, only half of what has been forecasted.¹

Production facilities are still experiencing basic supply chain issues and operational inefficiencies, due to manual processes. Automated processes and the consolidation of licensed producers will help alleviate this bottleneck, as larger producers can use smaller players to get product to market faster.

¹ Cannabis Industry Leaders

(1) Cannabis Industry Leaders
“Data have shown there is more supply than what is getting out to the wholesale channel, due to poor operational efficiencies.”

—Licensed producer

“Companies should be valuing EBITDA rather than sales or capacity for a more holistic performance measurement.”

—Licensed producer
Work in progress

Pricing

**Competition with the illicit market remains stiff**

While almost all licensed producers have positioned themselves as premium brands, the quality between them is hard to differentiate. The decision to be premium is reflected in pricing as well, which has left legal product unable to compete with the illicit market. *Since legalization, the average price per gram has been $9.99 for legal channels and $6.37 for illegal channels.¹*

The industry is ripe for a value play, to provide customers high-volume orders at affordable prices.

As the cannabis industry matures and supply begins to meet or exceed demand, it’s expected wholesale prices will fall. The industry should pass these savings on to the end consumer. It should also review the necessity of heavy security for distribution, which also results in higher costs and prices along the value chain. Should the focus be on commoditizing cannabis?

(¹) Statistics Canada 2019
“From a wholesale perspective, prices are decreasing. However, these savings are not being passed on to the end consumer.”

—Licensed producer

“An abundant supply will help to create competition on price and quality, accelerating the market faster and allowing wholesalers and retailers to be more aggressive.”

—Provincial cannabis board

“There is a potential for reduced prices. However, if everyone continues to position themselves as premium, we won’t see the prices come down.”

—Licensed producer
Vertical integration may not be optimal

The demand for constant production will make it difficult for companies to do it all. Licensed producers must stay focused on their core competency: growing and selling cannabis. Players who focus on mastering one aspect of the value chain will be able to prioritize innovation.

Such focus on key areas creates the opportunity for increased specialization. For example, co-packing is expected to become a large market as the size of the industry grows. And we have already seen a dependence on outsourcing in preparation for the legal edible market, since cannabis producers don’t have the time or facilities to produce food.
“The person who isolates THC won’t be the same person who mixes it into the chocolate, or puts it into packaging.”

—Licensed producer

“Vertical integration stunts innovation, because you’re stuck trying to control the supply chain.”

—Licensed producer

“Everyone is tended toward vertical integration, so what’s resulted are a bunch of companies that aren’t good at anything.”

—Provincial cannabis board
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