

Comparing Retail in the United States and Canada

By Ed Strapagiel

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The Key Points

Canadian retailers are often cited for following U.S. trends, including importing store formats and marketing concepts. Comparing retail sales in the two countries provides insight on what the leading developments are in the U.S., and which might be expected to arrive next in Canada. The migration of retail practices also acts as a test, because only the best ideas are likely to make the journey north.

There are many differences between the U.S. and Canada in terms of population size, social institutions, culture, climate, and so on. One key point however is that:

- Differences in the retail industries between the two countries have more to do with who the retailers are, rather than who their customers are.

American and Canadian consumers may have different tastes and preferences when they go shopping, but most of the differences in retail between the two countries can be traced to what choices they have of where they can shop. Related factors include government regulation and price differentials, but these are also based in the supply-side rather than the demand-side of the market.

- Both American and Canadian consumers spend practically the same 29% of their respective national Gross Domestic Product (GDP) in retail outlets.

How this converts to dollars depends on the exchange rate at the time, which has an offsetting effect on prices. Where the dollars are spent however is different between the two countries.

- Combination stores (superstores and warehouse clubs selling both general merchandise and food) are more developed in the U.S. than in Canada. This affects comparisons in almost every other retail sector, especially grocery.
- Combination stores are the current U.S. retail concept poised for export to Canada, a process which has already started.
- On the other hand, Canada has Canadian Tire, which has no U.S. equivalent. A special Canada-only industry category had to be created to accommodate it. Where Canadian Tire's sales are classified, or not, has a significant impact on how retail trade appears to be distributed.

One retail sector that may represent a real difference is do-it-yourself home improvement.

- Americans appear to spend proportionately far more than Canadians at home centers.

Aside from store classification problems, a part of the explanation may be climate, in that Canadians have a shorter season for home improvement and gardening projects.

A Common Basis for Comparison

Both the U.S. and Canada now report monthly retail sales based on the North American Industrial Classification System (NAICS). With common categories, it is now possible to draw more reliable comparisons of the retail business between the two countries.

Previous to NAICS, both the U.S. and Canada had been using the Standard Industrial Classification (SIC). Under SIC, some more recently developed sectors were not recognized as retail. Computer and office stores were treated as business equipment and supplies, while home improvement centers were classified with lumber yards. Both were reported as wholesale trade, and high growth retailers like Staples and Home Depot were not included in official industry statistics.

NAICS also produces a better relationship to Gross Domestic Product (GDP) in both countries. Under SIC, the retail industry appeared to be shrinking as a portion of the economy.

But Not Quite

The move to NAICS to standardize economic reporting stems from the North American Free Trade Agreement (NAFTA), which also includes Mexico.

- The three NAFTA countries however have some flexibility to customize NAICS for their own needs, and this can cause comparison problems.

There are NAICS codes that exist only in Canada, for example. Secondly, even though NAICS is a well defined and documented classification system,

- There is apparently no obligation to actually report the numbers with the same discipline.

For the United States, the U.S. Census Bureau reports on more retail categories, but leaves out certain classifications which are instead subsumed in totals, and state or regional breakdowns are not available on a continuing basis. Statistics Canada reports much fewer categories, but does provide provincial figures as part of their standard package.

In U.S. reporting, Grocery Stores include Supermarkets and Convenience Stores, but Canada shows Supermarkets separately and combines Convenience Stores with Specialty Food Stores, whereas Specialty Food Stores are a separate item in U.S. numbers. Both countries however do break out Beer, Wine and Liquor Stores sales separately.

And if you can follow all that ...

Take \$600 Billion Off the Top

The reported grand totals in the U.S. and Canada are not “apples and apples”. The U.S. grand total includes Food Services (e.g., bars and restaurants). It is very clearly labeled as such, although this does not always register with the media. Food Services however is in NAICS code 72, which is not Retail Trade, which is codes 44 and 45. So perhaps it’s no wonder that Statistics Canada reports Food Services elsewhere and not with retail.

The same argument however doesn’t hold for Non-Store Retailers, NAICS code 454. It does come under Retail Trade, and is included in U.S. figures, but is not included with the Canadian numbers.

Food Services and Non-Store Retailers represent about an 11% difference between the reported grand totals in the two countries on a relative basis. To get “apples and apples”, one has to deduct the two items from the U.S. figures:

- For 2004, the U.S. grand total will have to be adjusted down by about \$600 billion.

Considering that *total* retail trade in Canada will be under \$350 billion (Canadian dollars) in 2004, this is an enormous “adjustment”.

Location-Based Retail

On net, the U.S. may inadvertently overstate the case by including Food Services, but Canada understates retail trade by omitting Non-Store Retailers. But we can define a common measure:

- Location-Based Retail, which consists of physical stores, including the automotive sector.

This is what Canada actually reports as retail trade, and equals U.S. figures less Food Services and Non-Store Retailers. More precisely, Location-Based Retail is NAICS codes 441 to 453 inclusive.

Avoid the Exchange Rate

The usual, simple approach is to convert retail sales in the two countries to the same currency, whether U.S. or Canadian dollars, or even Euros for that matter. But it won't work:

- A simple exchange rate conversion will be misleading, due to fluctuations in the relative value of the U.S. and Canadian dollars.

Over the last two years, the value of the Canadian dollar has risen from 64¢ to over 80¢ in U.S. funds, so that:

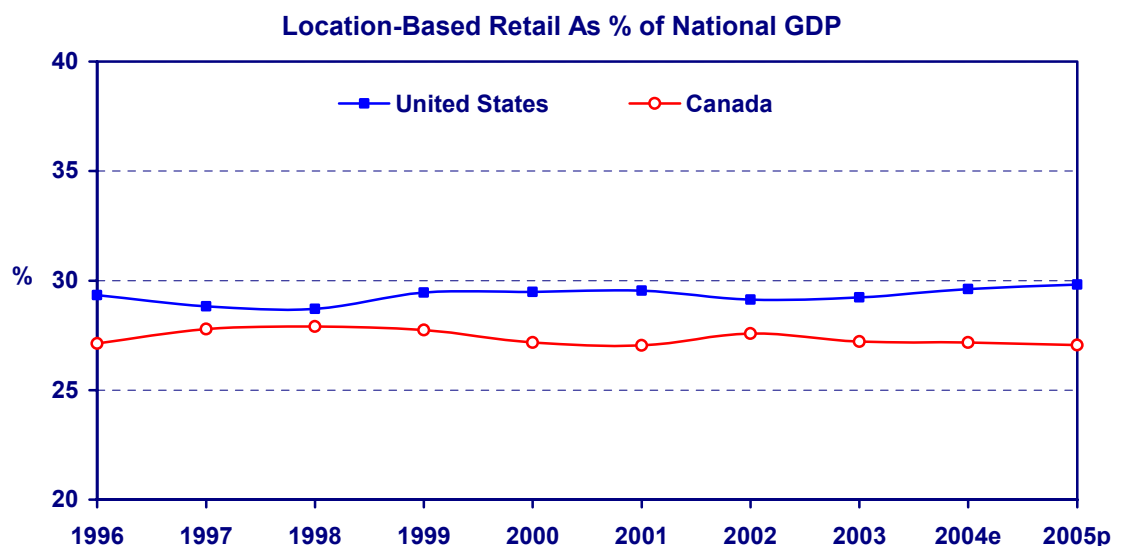
- A currency conversion done two years ago would have produced answers that are 25% different from doing exactly the same math today.

In the last two years, Canadian retail trade has certainly not sprung ahead of the U.S. by 25%. Simply applying exchange rates can produce deceptive results.

The main difference the exchange rate makes is that U.S. retailers with operations in Canada will show bigger numbers in their consolidated financial statements, and vice versa. The relative value of the U.S. and Canadian dollars however doesn't change the fundamental nature of retail and consumer behavior in the two countries, at least not in the short run.

Retail As a Portion of the Economy

A way of comparing the U.S. and Canada, while avoiding the exchange rate trap, is to look at retail trade as a portion of national GDP in both countries, as shown below.



Source: U.S. Census Bureau, Statistics Canada, and Kubas Consultants estimates and projections.

The results show that:

- Retail trade is a smaller portion of GDP in Canada than in the U.S.

The average difference is 2 percentage points, but the gap waxes and wanes, according to each country's economic conditions and retail supply/demand cycles. Since the two economies are closely linked, it is not surprising that the relative retail/GDP relationship tends to be maintained.

Sales Tax Evens Things Out

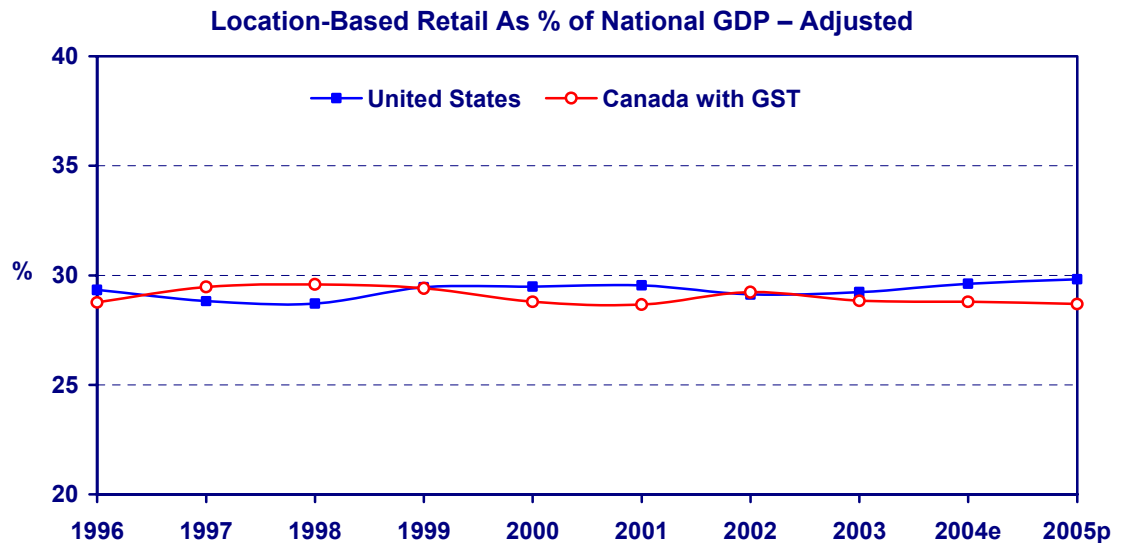
But we're not done yet. Many U.S. states and Canadian provinces impose sales tax on various retail goods and at varying rates. Sorting this out would be very difficult, so let's hope that the impact of state and provincial sales taxes tends to wash out between the two countries.

At the federal level however, there is a major difference.

- The U.S. has no national retail sales tax,
- But Canada does, namely, the Goods and Services Tax or GST.

The GST rate is 7%, but it does not apply to most food purchases nor on prescription drugs. Grocery and drug store sales however include many items on which GST does apply, such as cleansers, paper products and personal care products. Again, it's complicated, so let's just say that GST's net impact on overall Location-Based Retail ends up being 6% after the exemptions.

If we make this adjustment to Canadian retail, the revised picture is as follows.



Source: U.S. Census Bureau, Statistics Canada, and Kubas Consultants estimates and projections.

Aside from short-term cyclical fluctuations, the two trends in the chart are practically equal, with both ratios gravitating around the 29% level. In other words,

- Depending on how you look at it, there may be no effective difference in retail as a portion of the economy between the U.S. and Canada.

Professional economists might take issue over cavalier treatment of the relative tax regimes in the two countries. Retail trade however is not part of GDP, but consumer spending is. When Canadians buy in retail stores, they have to pay the GST, and they end up spending exactly as much as Americans as a percentage of GDP.

The Retailer's Perspective

For Canadian retailers however, GST is a flow-through and doesn't count as sales revenue. Retail trade then ends up a fraction smaller, depending on the balance of GST collections versus credits, so it might be about 28% of GDP. This is one point less than in the U.S., a difference which would be unnoticeable against the backdrop of normal ups and downs in the retail business.

Americans Have Bigger Wallets

Even if retail trade is about the same percentage of GDP in both countries, another matter is that the U.S. economy is proportionately larger than Canada's. In 2003, GDP per capita was:

- In the United States, \$38,800 per capita in U.S. funds;
- In Canada, \$38,400 per capita in Canadian funds.

The two figures are almost the same, but the Canadian dollar's value averaged about 70¢ U.S. in 2003, so Canadian GDP per capita was about 30% smaller, based on simple currency conversion. The retail slices may be the same, but the U.S. pie is bigger, so that at the end of the day:

- The retail industry is smaller in Canada than in the U.S. on a per capita basis.

Exactly by how much depends on the exchange rate when you do the calculation. Over the last few decades, the U.S. dollar has been relatively strong and the Canadian dollar depressed. So the general conclusion, that retail per capita is smaller in Canada, usually holds.

Or at least, this is the conventional wisdom.

But Canadians May Have (Had) Lower Prices

Americans and Canadians spend about as much on retail in terms of share of wallet, but Americans have more in their wallets to begin with. On the other hand, Americans may need more in their wallets to bring home as much from the mall.

Many Canadian prices have been lower when converted into U.S. currency than what appears on the sticker for the same item in a U.S. store. According to *The Economist's* "Big Mac Index",

- The average price at the start of 2003 of a MacDonald's Big Mac was \$2.65 in the U.S. versus \$2.08 in Canada, with both figures in U.S. dollars.

At least in this case, Americans needed 27% more cash in their wallets in 2003 to get exactly same thing, which all but offsets Canada's lower retail sales per capita.

Guess what this means? The 2003 U.S. and Canadian economies were about the same size if measured in Big Macs per capita! And this is not entirely a joke – in economic terms, the intrinsic value of a Big Mac is more constant and uniform than the worth of either the U.S. or Canadian dollar.

Another example is drugs, with busloads of Americans traveling north to get prescriptions filled at far lower Canadian prices.

Price differentials between the two countries however are a murky subject, because of small variations in many products and the effect of retail sales tax. Price comparisons also greatly depend on the exchange rate. Currently, since the Canadian dollar is appreciating, the price gap is closing.

Retail Sector Sales Ratios

Another approach that avoids exchange rates is to line up retail in both countries and look at sales ratios by sector.

In 2003, U.S. Location-Based Retail was \$3,210 billion in U.S. funds, while in Canada it was \$331 billion in Canadian funds. The ratio of the two is 9.7 without currency conversion. A U.S.-to-Canada ratio above 9.7 implies relatively higher category sales in the U.S. versus Canada, and vice versa. To make the ratio a little more intuitive, we have indexed it across categories, resetting the overall average of 9.7 to 100, as shown below.

NAICS Code	2003, \$ Millions	U.S. Retail in US\$	Canada Retail in Cdn\$	U.S.-to-Canada Ratio	Ratio Index (avg=100)	Relatively Higher Retail in:
Total	TOTAL LOCATION-BASED RETAIL	3,209,843	330,503	9.7	100	-
Subtotal	Store Retail	2,045,621	217,754	9.4	97	Canada +3
Subtotal	Food & Drug	698,124	98,897	7.1	73	Canada +17
Subtotal	Store Merchandise	1,347,497	118,857	11.3	117	U.S. +17
Subtotal	Automotive & Related	1,164,222	112,749	10.3	106	U.S. +6
Subtotal	FOOD & DRUG GROUP	698,124	98,897	7.1	73	Canada +17
445	Food and Beverage Stores	505,933	77,630	6.5	67	Canada +33
446	Health and Personal Care Stores	192,191	21,267	9.0	93	Canada +7
Subtotal	STORE MERCHANDISE GROUP	1,347,497	118,857	11.3	117	U.S. +17
452	General Merchandise Stores	471,078	40,011	11.8	121	U.S. +21
4521	Department Stores	214,129	20,801	10.3	106	U.S. +6
4529	Other General Merchandise Stores	256,949	19,210	13.4	138	U.S. +38
448	Clothing & Clothing Accessories	178,435	19,471	9.2	94	Canada +6
442	Furniture & Home Furnishings Stores	97,977	11,895	8.2	85	Canada +15
443	Home Electronics and Appliance Stores	94,561	10,970	8.6	89	Canada +11
444	Building Materials, Garden Equip. & Supplies	321,134	18,963	16.9	174	U.S. +74
451 + 453	Other Stores	184,312	17,547	10.5	108	U.S. +8
Subtotal	AUTOMOTIVE & RELATED GROUP	1,164,222	112,749	10.3	106	U.S. +6
441	Motor Vehicle and Parts Dealers	895,703	82,901	10.8	111	U.S. +11
447	Gasoline Stations	268,519	29,848	9.0	93	Canada +7

Source: U.S. Census Bureau, Statistics Canada, and Kubas Consultants calculations

Since the comparison is to the average between the two, U.S. and Canada appear about the same number of times in the last column above as the country in which retail sales are relatively higher.

- For the U.S., stronger retail categories are Building Materials, Garden Equipment & Supplies, General Merchandise Stores, particularly Other General Merchandise, and Motor Vehicle and Parts Dealers;
- In Canada, relatively stronger categories are Food and Beverage Stores, Furniture & Home Furnishings Stores, and Home Appliance & Electronics Stores.

Americans appear to spend more on their vehicles, while Canadians spend more on gas. It also seems that Americans eat less than Canadians, judging by the result for Food and Beverage Stores. And Americans seem to be far, far more preoccupied with home improvement and gardening than Canadians.

But how real are these differences?

Industry Structure and Other Explanations

Retail trade statistics do not measure *what* people buy, but *where* they buy it. The comparison of retail trade between the U.S. and Canada also reflects industry structure and other differences.

Do Canadians Drink Four Times More?

Both the U.S. Census Bureau and Statistics Canada report a separate figure for Beer, Wine and Liquor Stores. Had we included it in the table, the U.S.-to-Canada Ratio would be 2.5 and the Index would be 26. It would be the most extreme difference between the two countries, implying that Canadians buy relatively four times more booze than Americans.

- But that's not the case at all.

Almost all beer, wine and liquor in Canada is sold in government run or regulated stores. Americans on the other hand, buy alcoholic beverages mostly in other outlets, such as drug stores and supermarkets. The U.S. figure for Beer, Wine and Liquor Stores only captures specialty retailers in the category, and they appear to have about a 25% market share.

The retail sales comparison for Beer, Wine and Liquor Stores is a product of the regulatory environment, and has little to do with the true market or how much people drink. And that's why we left it off the table.

The U.S. Combination Store Effect

In the U.S., the single largest subcategory in general merchandise is Warehouse Clubs and Superstores. This sector accounts for the significantly higher retail sales ratio in the U.S. versus Canada in the Other General Merchandise Stores category.

Warehouse clubs and superstores however sell food too – it's about half of their business. So:

- It's not that Americans eat less than Canadians, but that Americans buy more of their food from combination (food plus merchandise) stores than from dedicated groceries and supermarkets.

This should also affect other categories:

- Combination stores likely also contribute to why Americans seem to shop relatively less at some specialty retailers, like clothing, furniture, electronics and appliances stores.

There are relatively few combination stores in Canada. Costco has operated in the country for many years, but Sam's Club arrived only in late 2003. Wal-Mart Canada operates conventional discount department stores which include a few food aisles, but it's nothing like their U.S. superstore format. Overall, combination stores are a much bigger factor in U.S. retail.

On the other hand, there is one significant and unique non-food combination store in Canada.

The Canadian Tire Effect

Canadian Tire is the most shopped retailer in Canada, and had \$6.25 billion (Canadian dollars) in sales in 2003. This was split approximately 40:30:30 among Home, Leisure and Automotive, according to their annual report. At Canadian Tire, you can get dishes, TVs, footballs, door hinges, leaf blowers, toys, and a new muffler. The problem is: how do you classify it?

Statistics Canada apparently found a solution by creating a new, Canada-only NAICS code, 452991, Home and Auto Supplies Stores, the description for which is:

- This Canadian industry comprises establishments primarily engaged in retailing a general line of auto supplies, such as tires, batteries, parts and accessories, along with a general line of home supplies, such as hardware, housewares, small appliances, sporting goods, and lawn and garden equipment and supplies.

The only major retailer in Canada that qualifies is Canadian Tire. It's truly in a class by itself.

The new code at least indicates just where Canadian Tire fits in the scheme of things, namely, under General Merchandise as an Other General Merchandise Store.

But another possibility might have been “Home Centers” or “Hardware Stores”, in which case Building Materials, Garden Equipment & Supplies sales in Canada would be higher by about a third. This would help somewhat to level out the large U.S./Canada disparity in this classification.

Also, it may not be that Canadians buy fewer auto parts, but that they’re buying them from a store that’s classified elsewhere. Canadian Tire is the dominant automotive parts and supplies retailer in the country, and was previously classified in Automotive under the SIC system.

Overall, Canadian Tire’s sales “lump” doesn’t fit comfortably into the NAICS set up, and this tends to warp the retail trade numbers. In fact, despite how polished and modern it is, NAICS doesn’t well handle combination stores of any kind, whether in the U.S. or Canada.

Less Do-It-Yourself Home Improvement in Canada?

Building Materials and Garden Equipment and Supplies Dealers (“Home Improvement” would have been easier) includes home centers, paint and wallpaper stores, hardware stores, other building materials dealers, outdoor power equipment stores, and nursery stores and garden centers.

The U.S.-to-Canada Ratio for this classification is extremely high and out of proportion to everything else. Americans appear to be spending relatively 74% more in home improvement stores. Most of the money is in home centers, the “big box” end of the business, but this retail format is about as well developed on both sides of the border. The “Canadian Tire Effect” would only explain about half the disparity at most.

- Perhaps this is the one retail category where climate really does make a difference.

Canadians have a shorter home improvement season (ditto for gardening), and may not be doing as much or using contractors more. Still, it’s hard to believe that paint lasts that much longer on Canadian versus American walls.

Do Americans Pay More for New Vehicles?

The single most integrated industry between the two countries is automobile manufacturing, due to the U.S.-Canada Auto Pact. Parts and assembled vehicles flow across the border constantly, in both directions. Currency fluctuations between the U.S. and Canada are a big headache for the auto industry, but it seems to have found ways to cope.

When the Canadian dollar plunged to 64¢ U.S., new vehicle sticker prices in Canada did not rise in proportion to match U.S. prices after exchange rate adjustment. Up to perhaps just last year, many prices were lower in Canada expressed in U.S. dollar terms, and so Americans were effectively paying more for their new vehicles.

Auto manufacturers responded by voiding warranties on vehicles purchased by Americans in Canada. Both governments also impose various regulations, duties and tariffs that very much discourage cross-border vehicle buying.

Now things have gone the other way. The value of the Canadian versus the U.S. dollar has appreciated by 25% in the last two years. So,

- Can Canadians expect a 25% sticker price decrease on new vehicles, in order to maintain the previous U.S.-Canada price relationship?
- The most likely answer is: Not a chance.

In order to maintain some exchange rate sanity, auto manufacturers appear to “massage” prices between the two countries. The result from retail trade statistics, that vehicles and parts are a relatively bigger retail business in the U.S., is at least somewhat artificial.

Coming up now, it looks like it might be Canadians’ turn to pay more.

In the Final Analysis

Comparing retail trade in the U.S. and Canada turns out to be a tricky business. Apparent differences can be caused by structural, regulatory or artificial circumstances, exchange rate movements, sales taxes, and pricing differentials. These factors tend to explain what at first seem to be disparities. So what we're left with is that:

- The character and relative scale of retail trade in the U.S. and Canada is almost the same.

There are two exceptions however which do appear to be fundamental:

- U.S. retail is relatively more developed in combination stores than is the case in Canada;
- Do-it-yourself home improvement seems to be a proportionately smaller retail sector in Canada than in the U.S., at least in part due to climate.

Combination stores (food plus merchandise warehouse clubs and superstores) have big sales numbers, and, by their nature, negatively impact sales in almost every other retail category. The ripples in the marketplace can be seen in the statistics.

Canada may well see more combination stores in the coming years, a trend which has in fact already started. Many retailers in Canada are U.S.-owned, and they often send what works north. Some incumbent Canadian retailers like Loblaws are already preparing, by opening their own superstores.

Combination stores rely heavily on economies of scale, which are more difficult to capture in Canada, due to a much smaller population. On the other hand, almost half of Canadian retail is concentrated in just six "VECTOM" markets (Vancouver, Edmonton, Calgary, Toronto, Ottawa and Montreal), whereas it takes about 15½ of the largest metros in the U.S. to get the same effect. Canada's big cities can support more American-style combo stores, which would bring retail trade in the two countries more into line.

As for the big difference in do-it-yourself home improvement, if it is driven by climate, then it's not going to change any time soon.

Ed Strapagiel is Senior Vice President of Kubas Consultants, a firm specializing in retail marketing and strategy. For further information, visit www.kubas.com. Kubas Consultants' retail trade estimates for both countries are available on our web site under Report & Articles.

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