

BC Food & Beverage CEO
Study – Fifth annual edition
West Coast companies
upsetting the apple cart



Foreword

Once again, it is an honour and a great pleasure to have the BC Food Processors Association participate in Deloitte's Food & Beverage CEO Study.

Although all businesses face the daily challenge of meeting their customers' needs, the added opportunity and/or threat from recent international trade agreements can have tremendous impacts on small and medium-sized operations. Imagine that one day your customer base is within one province or a western region, and the next day you're participating in a trade mission with access to millions of potential new consumers overseas. What will you do? How will you manage the growth? Where will you find the skilled people to take you to that next level? Exciting, yes. Scary, even more so.

Deloitte's report provides in-depth and descriptive scenarios with insightful questions to activate your business acumen and challenge the best from your organization. Contemplate the brutally honest truth about yourself and your organization so that you can rise to future demands in these exciting and challenging times.

Many thanks to Deloitte for their continued support of British Columbia's most valuable manufacturing sector. I encourage you to become engrossed in this comprehensive and useful report.

Sincerely,



Dave Eto
Chair, BC Food Processors Association



Deloitte introduction

We spoke with companies across the Pacific Northwest region of Vancouver, Seattle, Portland and San Francisco to learn how smaller food and beverage (F&B) companies are aligning their strategies, capabilities and financial structure to enable them to compete.

The consumer demand for products that are locally produced and have beneficial health attributes has opened the door to a new world for the F&B industry, providing the opportunity for innovative companies to come to market with products to meet this demand. While new consumer demands provide companies with opportunities, to truly be able to capitalize on this trend requires a business strategy and structure that enable the company to resonate with consumers. Our experience has found that this can be facilitated only through careful attention to and consideration of the following three competencies:



Strategy – A company needs to have a defined and focused strategy in place to enable product innovation and the development of core competencies in the company, plus brand communication and sustainability



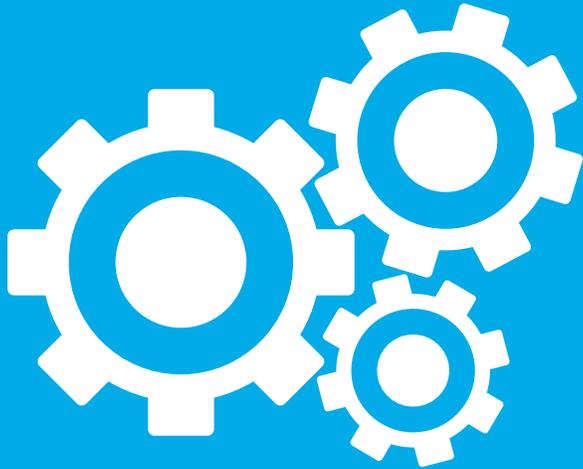
Capabilities – Senior management needs to have the expertise and experience to communicate the company's strategy and brand to the consumer



Financial – A company needs to have the *right* capital in place to facilitate sustainable growth and investment in the brand

Rick Kohn
Partner, BC Consumer Business
Assurance and Advisory Leader

David Lam
Partner, BC Mid-Market
Corporate Finance Leader



Strategy

“The flavour of the industry is in the West.” Ron Francisco, Horizon Distributors



Lesson 1 – Quality is key

How does one identify that certain *je ne sais quoi* that will transform a product from run-of-the-mill to revolutionary?

Five to 10 years ago, the organic, natural, ethical and ethnic F&B companies were in their infancy, facilitating a first-to-market advantage that was driven by the identification of gaps in the industry's ability to meet consumer demand.

Today, competition in the food and beverage industry means multiple players jostling for market share in what is becoming a highly fragmented arena. And consumers are following suit, breaking into many different groups, each with unique product and shopping preferences. Young and old, rich and poor, married and single, Caucasian and ethnic – Canada is a very ethnically diverse country – urban and ex-urban: all of these consumers have individual needs. They are looking for products and services that are authentic and local to their communities.¹

Depending on core competencies, the areas of taste, price, packaging, first-to-market position, sustainability and traceability are the focus for many smaller F&B players. However, the resounding message from all F&B companies in British Columbia is this: quality is key. Consumers are more educated now on the quality and nutritional value of the products they consume. Also, functional and nutraceutical foods are being consumed as a self-medication and for the prevention of disease. As sophisticated consumers raise their expectations, F&B companies need to raise their game in response.

As a result, the F&B industry is turning full circle – trending away from commercialized and homogenous products and returning to fresh ingredients and simple manufacturing processes. However, the quest for quality, affordability and healthy margins is ever prevalent. Cost-conscious shoppers are searching for value and quality – characteristics that are no longer allowed to be mutually exclusive.

As F&B companies grow and migrate from the start-up to the growth stage of their life cycle, brand strength and product quality are jeopardized by dilution as they aim to please a wider and more diverse customer base and as they progress from batch to large-scale production. The ability to conserve the product's quality-related characteristics and to maintain authenticity will differentiate those companies from their competitors and ensure longevity of brand and product.

“Trailblazers are those companies that are able to remain steadfast in their product and core competencies.”

Rick Kohn, Partner, BC Consumer Business Assurance and Advisory Leader

The Chai Company has taken the importance of quality one step further by investing in an external audit of their production facility and gaining third-party certification of their quality promise. *“As we grow, we are looking to partner with global companies that will deal only with third-party certified producers. So we decided to institutionalize our quality piece.”* – Chris Merry, President, The Chai Company

¹Mid-Market Food: *Small is Beautiful*, 2013, Deloitte Canada.



What about our US Pacific Northwest counterparts?

Prioritization of quality is uniform across the Pacific Northwest. US companies in particular recognize the importance of packaging in communicating their message of quality. Moreover, availability of information is an integral part of the packaging strategy – the expectations of consumers in the US regarding information detailing the nutritional values of a product are substantially elevated in comparison to Canada.

“We recognized the ‘power of the visual’ early on. Instead of asking for our product by our company name, ends users (chefs and retail buyers) would ask for the ‘blue box.’ They recognized the quality of our product and remembered the packaging, and we in turn recognized the ‘power of the visual’ in our branding.”

William Dresser, President, Sea Port Products Corp.

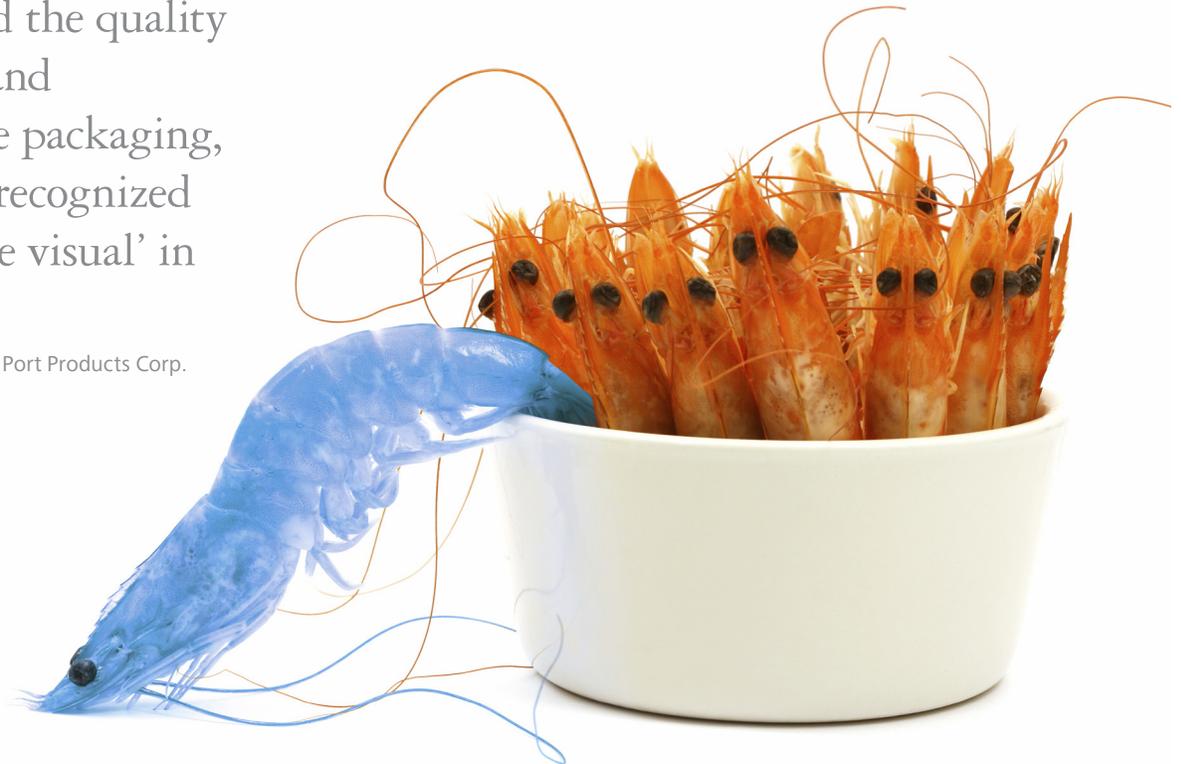
Brain Food

BC:

- Are you ranking quality above all else when determining your company’s mission and goals?
- How are considerations such as taste, price, packaging, first-to-market position, sustainability and traceability being factored into your strategy and your day-to-day operations?

Western US:

- How do you maintain quality across the larger geography of the US Pacific Northwest?
- Packaging and nutritional information availability are championed in the US through consumer demand for a more informed shopping experience – how do you incorporate such information while continuing to draw the consumer’s eye?





Lesson 2 – Integration of the company’s core competencies into the product brand is a must

“It’s not enough to just talk about the quality of your product. To be authentic, we must walk the walk in all aspects of our business, from product to service to people.”

Oguz Istif, Finance and Operations Manager,
Vij’s Restaurant

The core competencies of a company should go hand in hand with the product’s brand. The challenge, however, for small and growing companies is how to safeguard the necessary focus on the company’s core competencies while ensuring that the day-to-day operations and administrative support functions for the company tick over.

We are observing smaller companies in the F&B industry divesting themselves of peripheral functions such as packaging and manufacturing processes to allow their time and resources to be focused on core competencies such as new product research and development, sales, marketing and brand development. This gives management the ability to focus on preserving the company’s core competencies within the brand and products that they develop. As an added benefit, management also finds that it promotes improved reaction time to changes in the market and therefore utilization of first-mover advantage – outsourcing functions to companies who prioritize it as their core competency means they are well positioned to adjust promptly to changes in process and packaging while maintaining profitability.

That said, care must be taken in selecting reputable outsourcing partners. To retain brand strength and product quality, F&B businesses need partners that can provide safe, high-quality and low-cost services.

Other F&B companies are opting for the more direct route of communicating their core competencies via their brand and product names. Nutriva, Ethical Bean Coffee, PROsnack Natural Foods and Left Coast Naturals all identify their primary core competency through their brand name. Punjab Milk/Nanak communicate their core competency of pure, quality ingredients in their products through simple yet direct tag lines such as “Symbol of Purity” and “So Good, So Pure; It’s Nanak”.

Whether you prefer to integrate and communicate your core competencies via the outsourcing of peripheral functions, or via product names or tag lines, it is important to maintain consistency in your core competencies, as well as the quality and delivery of such core competencies, at all times.

“The consistent quality of service and trust that people have with our product is key. To be known as the go-to company for tofu products and for information regarding uses of tofu is fundamental to our brand and strategy.”
– Peter Joe, CEO, Sunrise Soya Foods

What about our US Pacific Northwest counterparts?

With the size and diversity of culture and products across the US, there is a higher risk of core competency dilution as companies seek to please an array of consumer demands. However, the population density in the US in comparison to Canada allows smaller F&B companies to align their core competencies with discrete regions/states while still servicing a larger consumer base. During our interviews, the consistent message received from US and Canadian companies alike was the importance of focusing on the communication of your core competencies to your local consumer base, whether it is in BC, Washington, Oregon or California.

“If you can’t sell effectively in your local area, then you’re not going to succeed externally. It’s not about having a wide range of products and distribution – it’s about having a quality portfolio that sells, and a core group of customers who are loyal to your brand.”

Ian Walker, President, Left Coast Naturals

The advantage that smaller US food and beverage companies have over their Canadian counterparts is their access to a larger population. The US market has its challenges for BC-based F&B players; however, a focus on the Pacific Northwest region offers great synergies and potential for those able to execute a defined strategy of expansion.



Brain Food

BC:

- Challenge: How do you incorporate your core competencies into your brand while maintaining day-to-day operations and functions?
 - Solution 1: Consider outsourcing peripheral functions, facilitating greater focus on the foundations of your business.
 - Solution 2: Consider simplifying your method of core competency integration, through direct tag lines and indicative product names.

Western US:

- The risk in the US of core competency dilution is increasingly prevalent as a result of high population density and diversity.
- However, with population density comes opportunity – have you contemplated a focused communication strategy in the US to capitalize on these opportunities?



Lesson 3 – Both your sales staff and your distributors are instrumental to communicating your story

The general consensus from the smaller F&B players is that distributors may be a necessity when it comes to geographical coverage; however, they are not to be relied on in terms of marketing their products. Many owner-managed companies have a desire to retain control of their marketing strategies. For F&B companies, this includes marketing to the end user as well as to the retailers.

While grocery retailing in Canada is displaying some room for further consolidation, the industry is down to just a handful of players. As a result, personal and enduring relationships with these retailers are highly valuable. Consequently, we observe significant worth in the personal servicing of large accounts. This further ensures consistency of message and prioritization of the company's core competencies.

And this is not inconsistent with the perspective of distributors:

“Don't expect distributors to be your marketing team. Our job is to monitor your product – we have the capabilities to provide valuable data and insight into the success of your product in the market.”

Ron Francisco, Horizon Distributors

As consumer taste is becoming more fragmented, companies are facing numerous challenges when implementing marketing strategies. The advantage of being a smaller company with a flat organizational structure is that decision-making and knowledge transfer are more efficient – complementing a learning organization, knowledge of customers and knowledge of competitors. The most common marketing method deployed by F&B companies in our survey is spending time on the ground with consumers and building relationships and loyalty through face-to-face interaction, supported by secondary methods such as social media and push advertising.

Equally important is building a strong relationship with retailers. Retailers seek products that set them apart from other retailers. Smaller companies operate in a challenging environment where they don't have strong bargaining power. Despite these challenges, smaller companies can build a track record of reliability with retailers through quality control of their service and product.

One BC-based food and beverage company owner appreciates the value of his relationship with his buyers: *“The little things matter to retailers – you need strong stock, no damaged products and the ability to service the store well. If you have a great product, then it will sell; however, it is important to build goodwill with retailers, which can be leveraged in the future.”*

That is not to underestimate the importance of distributors. When it comes to geographical reach and connections, distributors play an invaluable role in the growth of a company's product and brand, particularly in countries as geographically large as Canada and the US. This is of particular importance to smaller F&B companies who do not have the resources to manage and execute distribution channels across large geographical areas in the early stages of their company life cycle. At this stage, distributors should be used to your advantage.



“The key to a successful relationship with distributors is to treat everyone equally, ensuring they all have the same playing field” – Jim Pratt, Co-Owner and Director, PROsnack Natural Foods

What about our US Pacific Northwest counterparts?

Of the 100 largest retail chains in the world, 32 are supermarket and grocery store chains. In the US, 20% of the retail chains that are the largest in the world are grocery stores and supermarket chains. This illustrates the power of the supermarket and grocery store retailers in the US.² As a result, the grocery world in the US compared to Canada varies greatly, with fiercer price competitiveness resulting in skinnier margins.

Due to the distribution challenges in the US, brokers are common practice. Managed correctly, brokers bring value to the distribution chain. As with distributors, the challenge is finding a broker that represents your primary goals and promotes your core competencies. This can take time and money, but it can have a significant impact on your top line.

In Canada, recent success stories are likely to encourage F&B companies in BC to take the time and money to investigate further.

Brain Food

BC:

- Building strong relationships with the large grocery stores is an important asset that requires time and resources.
- Is your brand message consistent and clear?
- Are your core competencies applied consistently throughout your marketing and sales strategy?
- Distributors have geographical reach and industry connections – are you giving them sufficient consideration?

Western US:

- Grocery store retailers and supermarkets hold all the power in the US – their size and distribution channels ensure fierce price competition and skinny margins for F&B companies.
- Brokers can provide the bridge needed to manage relationships with grocery stores in the US – have you spent time researching brokers, and do you understand the services they offer?

“With the recent introduction of brokers to our distribution channels, we are on track to be in an additional 695 stores by September 2014. The brokers’ knowledge of the market and their established relationships with distributors ensure that our product gets the attention it should.”

Mickey McLeod, Co-Founder, President and CEO, Salt Spring Coffee

²Global Powers of Retailing 2014: Retail Beyond begins, Deloitte US



Lesson 4 – Corporate social responsibility and sustainability are here to stay

Corporate social responsibility (CSR) and sustainability have gained momentum over the past few years. No longer is a company's priority merely to generate revenue; sustainability and longevity of their business is becoming integral to strategic planning. As a result, management is recognizing that sustainability is an opportunity for innovation and growth. By following sustainable practices, brand awareness can be enhanced, strengthening company reputation and opening up new markets.

For CSR to be successful, it needs to be central to the business – and linked to key management considerations such as organizational development, strategic planning, human resource management, risk management, supply chain management and ongoing operations. This can come in the simple form of hiring local employees, implementing responsible supply chain management and ensuring the engagement of all stakeholders with the business.

Such engagement can lead to the gaining of a social licence, which is defined as existing when a project has ongoing approval and social acceptance within the local community and with other stakeholders. The normative components of the social licence comprise the community/stakeholder perceptions of the social legitimacy and credibility of the project, and the presence or absence of true trust.

Corporate social responsibility is not all about philanthropy or doing charity services for the community. That is not to say that such activities are unimportant. However, they can become superficial manifestations of CSR if they are addressed as stand-alone initiatives in the business without being integral to all aspects of the business.³

“If you put CSR out up front as a marketing tool, then you’ve already lost the battle. If you follow ethical and sustainable practices throughout your business, there isn’t a need to talk about it.”

John Scharffenberger, Co-Founder, Principal and President, SCHARFFEN BERGER Chocolate Maker

Smaller companies can build an authentic relationship and brand with their targeted consumer group by being visible in the community. Authenticity and connection with consumers may allow the company to spend proportionately less on marketing, which is critical to branded products, as it allows consumers to trust in a high-quality product.

Large public companies across North America are seeing increasing regulation in the incorporation of sustainability in their reporting framework. The Global Reporting Initiative (GRI), which is a leading organization in the sustainability field, has developed a comprehensive Sustainability Reporting Framework that is widely used around the world, enabling greater organization transparency and accountability. The Global Impact Investing Rating System (GIIRS) is a comprehensive and transparent system for assessing the social and environmental impact of companies, and B Corporation provides a framework and certification for companies wishing to benefit society as well as their shareholders. Today, there are 1,008 certified B Corporations in

³Corporate Social Responsibility: *What it really is, Why it's so important, and How it should be managed*, David Waldman, Ron S. Kenett & Tami Zilberg.



33 countries, including Ethical Bean Coffee, Guayaki Sustainable Rainforest Products, Left Coast Naturals, Numi Organic Tea and Salt Spring Coffee. And while the GRI and GIIRS are primarily focused on public companies, public pressure encourages all companies to be operating under these frameworks.

And, finally, with the growth in prominence of social responsibility and sustainability comes a demand for social entrepreneurs. Innovative approaches to sustainability offer a great opportunity for F&B companies to differentiate themselves from their competitors.

What about our US Pacific Northwest counterparts?

Corporate social responsibility is a global topic receiving attention across all parts of the world. In the US, the focus is on responsible sourcing of materials, commodity cost volatility and sustainability. Growing concerns about public health, societal issues and environmental sustainability are encouraging the US government to examine increasingly aggressive approaches to the regulation of different categories of consumer goods. For instance, the *Food Labeling Modernization Act of 2013*, which has been referred to the House Committee on Energy and Commerce, indicates that the Food and Drug Administration (FDA) would have to establish a standard front-of-pack nutrition labelling system for all products, would make manufacturers indicate caffeine and added sugar on package labels, and would make ingredient labels easier to read. The bill also aims to eliminate allegedly deceptive claims for conventional foods and to update nutritional labelling requirements.⁴

The cost of obesity in the US is likely to rise to about \$344 billion in medical-related expenses by 2018, eating up about 21% of health care spending.⁵ As a result, the government's focus is going to remain on the regulation of food and beverages, and US F&B players will need to ensure that social responsibility is a significant part of their strategic planning.



Brain Food

BC:

- The current "Take, Make, Waste" model is on its way out and the "Circular Economy" is the new kid on the block.
- Have you made CSR and sustainability central to the running of your business?
- Are you communicating to, and appreciating, all stakeholders of your business effectively?
- Have you considered the opportunities that CSR presents, to allow smaller companies to build relationships and brand eminence?

Western US:

- Corporate social responsibility is a global initiative followed with fervour in the US.
- Are you considering the implications that more stringent regulation surrounding consumer goods and sustainability will have on your business in the future?

⁴Regulatory update, November 2013, Deloitte.

⁵Joint report by the United Health Foundation, the American Public Health Association, and Partnership for Prevention, 2009.



Capabilities

“The key to our success is corporate culture – our employees must have a genuine connection to the product and a genuine connection to the people they work with, internally and externally.”

Michael Lansky, President, Terra Breads





Lesson 5 – Knowing what the consumer wants is a challenging yet fundamental ingredient to growing your market share

Understanding what consumers are looking for in a product and then communicating your brand and product philosophy to consumers is a challenging yet fundamental stage of growing market share and presence. Entrepreneurs and business leaders need to recognize that in order to succeed in this field, they need to have people around them with the right expertise.

The advent of the Internet allows smaller companies access to information and comparative data that wasn't previously available, allowing them to react quickly to market trends and access information on a more timely basis. Nevertheless, it is important to create opportunities for consumer interaction – via the company website, mobile devices or other means enabling two-way communication. While this appears straightforward in theory, the time and resources required to implement an effective communication strategy can be arduous for an owner-managed business.

"Blogging is a wonderful two-way conversational tool, but it takes an enormous amount of time to manage."
– John Scharffenberger, Co-Founder, Principal and President, SCHARFFEN BERGER Chocolate Maker

The local BC market has an openness to new ideas because of the diversified ethnic population and a focus on healthy living, and the Pacific Northwest coast has become a centre of excellence for innovation, with the likes of Apple, Amazon and Google inspiring companies up and down the coast to perfect the art of innovation. The rich variety of cultures in BC provides a marketplace of choice, competition and demand along with willing/experimental consumers.

Hence, we encourage local businesses to be innovative with marketing. Technology provides us with multiple channels directly connected to consumers, allowing us to uncover consumer needs and sentiment. And it allows consumers to become involved, gain information and act as product evangelists.

"For our marketing strategy, we are becoming more focused on connecting with the emotions of the consumer rather than leading with and complicating it with the innovation message." – Bill Vanderkooi, Founder and CEO, Nutriva Group

For Ethical Bean Coffee, transparency, executed through emark technology, was a fundamental part of their strategy in winning new customers. In the grocery store, customers are able to scan the emark that can be found on every bag of Ethical Bean Coffee using their iPhone app, and can follow their coffee's journey from farm to shelf, viewing farmer interviews, locating the field in which the coffee was grown and reviewing the Fairtrade Organic certification.

"Implementation of the emark technology required significant changes to our internal systems and databases. However, it has enabled us to bring in new customers in a highly competitive market."

Lloyd Bernhardt, CEO and Co-Founder, Ethical Bean Coffee



What about our US Pacific Northwest counterparts?

In the US, there is a greater need to understand and differentiate between the consumer demographics that you are targeting. The US population stands at close to 318 million,⁶ compared to 35 million in Canada.⁷ Given the divergence of cultures across the US, it is more appropriate to break the US down into its states to gain a better understanding of the target consumer base. Canada, on the other hand, is best divided between east and west, with the two regions showing select similarities that allow products to be tweaked accordingly.

Equally, the western states in the US display resemblances to each other and, as a result, F&B companies in the US Pacific Northwest region are prone to securing customer loyalty in their neighbouring coastal states before considering expansion inland and to the east coast.

Brain Food

BC:

- Are you taking full advantage of the Internet by accessing comparative data and information?
- Have you maintained consumer interaction as a priority in your marketing strategy? Company websites, mobile devices and social media can all encourage two-way communication.
- Have you considered the innovative and diversified consumer base present in the BC market? How about encouraging innovation in your marketing strategy to generate product evangelists?

Western US:

- The US is too large and too densely populated to consider as a whole – have you considered breaking it down into states to better understand your target customer base?
- Have you noticed the similarities in consumer base shown between states in the Pacific Northwest? And have you thought about leveraging these similarities to expand outside of your direct consumer base?





Lesson 6 – Effective, enduring branding is best executed by creating meaningful connections with consumers

“With premium-branded food companies, you need to be clear on your price gap management strategy – optimal pricing, along with a marketing strategy, from social media to your packaging, that can effectively articulate the brand and the brand promise.”

David Lam, Partner, BC Mid-Market Corporate
Finance Leader

Consumers are journeying along a new and winding path to purchase as they embrace the omni-channel experience. The following key takeaways are pertinent to the challenge of growing and establishing your brand in the market:

- Enable your customers to connect and interact with your brand
- Develop a consistent and compelling customer experience across all channels
- Listen to customers through all channels
- Understand the new and different paths to purchase
- Don't analyze post-purchase data alone
- Use data analytics to better understand your customer⁸

The above fundamentals highlight the difficulty of balancing scarce resources against the need to be empirical in strategic decision-making. Data analytics is an important piece in the puzzle of effective marketing. And it is more readily available than many company owners realize:

“In the ‘Age of the Customer’, organizations will have to be fully committed to implementing and continuously improving the customer experience. Analytics is the key to translating data into meaningful and executable customer strategies to drive customer acquisition and retention plus wallet share growth, margin expansion and returns on marketing investment.”
– Tom Peters, Partner, Data Analytics Financial Advisory Services

Traditional marketing strategies tend to favour the larger players with bigger pockets. Opportunities for smaller players are improved when they take advantage of social media and passionate early customers who, in turn, become evangelists for the new brand. The benefits of marketing initiatives in terms of propelling organic sales growth are often difficult to measure; however, building an established brand is recognized as a main factor in increasing profitability.

Facebook is a great marketing tool, but “face time” is better.

Facebook and Twitter add value and generate grassroots buzz for smaller manufacturers and processors, but must be used in conjunction with product sampling and community support, whereby companies connect directly with the consumer. However, the value of social media shouldn't be overlooked as a way to complement face-to-face initiatives.

⁸Creating customer-focused growth: A framework for creating sustainable customer value, Deloitte Canada.

The grassroots approach is consistent with most research findings that consumers trust peer recommendations and word of mouth over general advertising. Social loyalty (namely, the provision of customer incentives through social communities) is a new and important trend. Over 50% of customers trust friends and family, while less than 25% trust any form of marketing or advertising. Companies can encourage word-of-mouth recommendations and create brand advocates by focusing on delivering a differentiated level of service.

The basics of trade shows, store demos and regular store manager interaction in generating and growing customer loyalty have endured through the evolving media and marketing landscape, as has packaging – which is still the number-one method for many companies of communicating their story to the consumer, particularly for those products found primarily in grocery stores.

“Our packaging is like our billboard. We are a niche product; therefore, we need our packaging to constantly be drawing the consumer towards the product.”

Peter Joe, CEO, Sunrise Soya Foods

What about our US Pacific Northwest counterparts?

In the US, there is a need to have people on the ground who are connected with the market, the media and the local people, and who bring value to the marketing strategy. Expansion in the US requires investment in local markets to ensure powerful messaging and marketing, rather than taking the US as a whole and risking dilution of brand through generic messaging. And while the most cost-effective approach to marketing is to have the capabilities in-house, smaller F&B companies are opting to outsource to capitalize on the local knowledge and network that marketing agencies deliver.

“The big difference we found with our marketing strategy in the US was that everything had to be done more loudly. US consumers expect things to be put on their plates, figuratively and literally, whereas Vancouverites prefer a more subtle approach.” – Oguz Istif, Finance and Operations Manager, Vij’s Restaurant



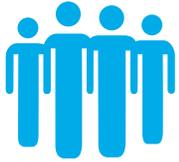
Brain Food

BC:

- A well-established brand with a track record for quality lessens price sensitivity and offers scope for premiums to be charged.
- Have you considered data analytics to help execute an effective marketing strategy?
- Social media is a great way for smaller players to connect with their customer base at an affordable price, but are you incorporating sufficient face-to-face initiatives into your marketing strategy?
- Are you utilizing your packaging as your primary billboard to customers?

Western US:

- Marketing agencies in the US offer the local knowledge and relationships necessary to connect with local consumers – have you considered connecting with such agencies to explore further opportunities in the US Pacific Northwest?



Lesson 7 – Communication of your company’s story is contingent on the hiring of the right people for your sales and marketing team

Passion is consistently recognized as being an important success driver; an entrepreneurial and passionate culture can be a company’s competitive advantage. If you are able to foster a culture of passion in the organization and instill enthusiasm towards the company’s mission and product, communication of the company’s story is a powerful and meaningful tool.

During our survey, we found ourselves having the same conversation with our participants, with varying responses. Is it most important to hire (a) sales staff with proven sales skills who can be taught to be passionate about your product and brand, or (b) individuals with a genuine passion for your product and core competencies who can be taught to be effective sales employees?

A number of companies highlighted their focus on individual personality and culture when hiring sales and marketing staff, and on belief in their product. For Nutriva, sales experience was not considered as critical as having an individual who understands the values and role of the company and who is passionate about spreading the message.

Other companies in our survey determined that sales experience, particularly in different distribution channels, was decidedly important when hiring sales and marketing staff. They recognized that each distribution channel has different characteristics, characteristics that are heightened when you look outside of BC to eastern Canada and into the US. Experience in the F&B industry, geographically, was found to be a determining factor in the hiring process. Consensus for these companies was that training programs can be implemented, and best industry practices can be followed, to train employees in the company ethos. By instilling passion and culture within the company, employees will be engaged and entrepreneurial. Management can lead by example, participating in group work and encouraging team members to go beyond their titles.

“Anyone who’s a good salesperson can talk themselves into being passionate about a product.”

CEO, San Francisco food and beverage company

“Vitala is very unique company; therefore, there is limited opportunity to present meaningful prior sales experience. We’re more interested in someone who shares our values, is flexible and is able to work with our organizational structure.”

Bill Vanderkooi, Founder and CEO, Nutriva Group



Conversely, some companies within our survey found the hiring of sales and marketing staff to be a moot point – early-stage players revisited the philosophy of outsourcing non-core competencies, while others recognized that multi-tasking is an essential attribute for any owner/manager when in the early stages of the business life cycle.

Streamlined management can be a huge benefit for smaller companies. Multi-tasking and a multi-disciplinary approach allow smaller businesses to make decisions quickly and execute rapidly on new ideas. By being focused on developing an entrepreneurial and passionate culture, smaller companies can capitalize on a structure that is difficult for larger companies to imitate.

"Many of the food and beverage companies in the US are still family owned. This allows for a passionate workforce and for decisions to be made easily and quickly. Naturally, family culture influences how you hire people, looking for individuals that will fit and ensure continuity."

– William Dresser, President, Sea Port Products Corp.

Brain Food

BC:

- Are you fostering an environment of passion and entrepreneurialism in your workforce? Have you considered the impact that passion can have on your company and its competitive advantage?
- When hiring sales and marketing staff, have you considered the importance of personality and culture fit versus hands-on sales experience in the F&B industry? Are you giving both factors sufficient consideration?
- How strong are your multi-tasking abilities? Have you considered enrolling in some external sales training?

Western US:

- Have you considered the similarities the West Coast displays in attitude towards the importance of passion, culture and innovation in the workplace?





Financial

“Customers would like the best product, sustainably sourced and produced, at the best price. So we have to try to do that.”

President, Seattle food and beverage company





Lesson 8 – Early-stage financing requires patient investors and efficient management

“Our strategy was to grow as fast as our private financing would allow. We prefer patient capital and building the business sustainably. We would consider an angel investor if they were willing to be patient, but the reality is that outside investment precipitates pressure to grow.” Ian Walker, President, Left Coast Naturals

Insights from First West Capital

First West Capital specializes in subordinated debt and mezzanine financing solutions for small and mid-market companies in Western Canada, and provides the following insights regarding early-stage financing:

Start-up entrepreneurs need to be creative in the face of a fragmented, discerning and relatively illiquid venture finance market. They can use innovative sources at varying stages, including factoring, government tax credits and even crowd funding, to supplement their own money and insiders' capital.

Skin in the game from founders is a prerequisite to most investors. As important as the money is the signalling – that you are fully committed to the business. The investment should come from real dollars invested as well as from sweat equity.

Factoring is a good bridging option before qualifying for a business line of credit. The cost of capital is high, but this speeds up the cash cycle to enable sales growth. However, it is advisable to seed a bank relationship early, even before you qualify for credit. Build trust with your track record and move to a senior lender as soon as possible.

At some point, an early-stage business will grow beyond friends and family and other early-stage funding sources. This usually occurs when the business has gained market acceptance, has sales of half a million to a couple of million dollars and is growing its market. At that point, the decision looms between angel funding, venture capital or venture debt. In all cases, the entrepreneur should look for partners who can help them succeed over the long term, as this funder could be around for a long time.

Angels and venture capitalists can provide valuable strategic advice and connections, and preferably would be able to participate beyond the series A round. In the F&B industry, angels seem to be more prevalent. Equity from angels will be more patient, but this carries a costly dilution factor in the early stages of a company's growth. On the other hand, it can be difficult to raise equity, and the process will likely take your attention away from growing the business. What is the cost of that distraction?

Venture or mezzanine debt is less dilutive and costly, with return requirements in the high teens or low twenties. Aim to choose the right partner with a long-term view, one who understands that there will be ebbs and flows in the company's growth (it's the ebbs that count). Conversely, it is possible that a debt structure could hamper rather than assist an early-stage company. While the right partner can offer some flexibility, the inherent constraints of debt – repayment and covenants – should be considered in a downside scenario.

The question often comes up: when should I accept dilution? Raising a large equity round when the valuation is still in its infancy will mean giving up a lot, even control. Bridging with alternative lenders to a later equity round could be the better strategy if there is a path to profitability within the existing product suite.

Crowd funding on sites such as Kickstarter and Indiegogo is a current trend for would-be entrepreneurs to get a business off the ground or a new product onto the production line. Crowd funding allows entrepreneurs to give away some equity in their company in exchange for investment. It can also be a good gauge on whether there is interest in a product, and can be a proving ground before going on and looking for angel investors for bigger investment. However, it entails dealing with a number of individuals, as opposed to one organization with a single point person.

What about our US Pacific Northwest counterparts?

Our findings in BC are generally consistent with the approaches being taken by smaller F&B companies in the US for start-up funding.

A number of F&B companies have a preference for wealthy individuals or angel investors due to their tendency for a lower level of involvement in the business. Venture capitalists, on the other hand, show greater patience and understanding of the business, with preference for reinvestment of profits over dividends, but in return they expect greater involvement in business decisions. This can too often lead to more intensive pressure for growth of revenue, without sufficient focus on bottom-line profit.



Brain Food

BC:

- Have you considered funding sources outside of friends and family, such as angel funding, venture capital or venture debt?
- What stage of the growth cycle is your business at? Is it ready for equity investment, or in need of alternative lenders to bridge the gap?

Western US:

- When considering sources of equity, have you taken into account the value an investor brings to the table, aside from capital?





Lesson 9 – Long-term financing depends on the propensity for growth and the level of risk being retained

Growth often requires production capacity expansion. As a result, sufficient capital and financial resources in place are critical for branded product development success. Many F&B companies are confronted with the choice between opting to partner with strategic private equity firms or reinvesting internal cash flow to develop their brand. As a result, there is a trade-off between the speed of brand growth and the level of risk being retained. Aggressive actions can result in instability and substantially higher risk. However, the introduction of outside financing can provide additional capabilities that a company currently lacks, particularly from private investors. Equity gives them a stake, and therefore motivation, in the success of the business. And equity investors can be patient.

Continuing the trend of Lesson 8, the third and most popular financing choice is to take on debt. The majority of our participants are sporting capital structures with very limited external equity and debt instruments such as operating lines and equipment loan lines to meet expansion requirements.

Insights from First West Capital

Certainly, debt makes up the vast majority of growth financings. With growth past the start-up stage, some measure of predictability becomes apparent, which can be married to debt financing and repayment. The question is, what form of debt? Too often, companies mix up short-term debt with long-term capital needs – funding equipment purchases from a line of credit, for example.

Debt is only useful if you can make more money than the cash flow costs – which relates back to strategy and execution.

Beyond lines of credit and equipment term loans or leases, the costs of market expansion and product development bring to the fore the question of “should I partner with a private equity group or look at lower cost debt options?” The answer depends on the scale of the opportunity and the pace of acceleration needed. If your products are taking off and larger markets beckon, some entrepreneurs have successfully partnered with private equity, both for the large sums of capital needed and for the strategic value they bring.

Private equity takes a disciplined value creation approach, combining a defined process for exit that can yield great returns for founders. Private equity also brings involved and active partners, who will be motivated to quickly drive growth in enterprise value. That philosophy must align with your values and the time frame to exit as well as your propensity for accountability and shared decision-making.

Subordinate debt or mezzanine finance can bring the capital required without the dilution factor, and is useful for medium to fast growth, but perhaps not hyper-growth.

While a number of our participants cite the importance of their account manager relationship as the main driver in their choice of debt provider, we encourage BC F&B companies to go to market and push for the most competitive financing structure available. A good account manager and a competitive financing structure need not be mutually exclusive.



What about our US Pacific Northwest counterparts?

There is a common thread throughout the Pacific Northwest region that owners are perpetually worried about their percentage ownership in the business. However, with the plethora of venture capital and private equity firms in the US, there is a greater appreciation for the experience and value such investment can bring to a company that has a proven market success, and is on a strong growth trajectory.

“You are better off owning 25% of something really good rather than 75% of a nightmare business that keeps you up at night.”

John Scharffenberger, Co-Founder, Principal and President, SCHARFFEN BERGER Chocolate Maker

Brain Food

BC:

- What form of debt is best suited to your capital needs?
- Is the long-term nature of your return on investment factoring into your decision-making process?

Western US:

- Have you considered the benefits of private equity in executing accelerated growth strategies?





Lesson 10 – Utilization of government programs should be a priority for smaller and growing F&B companies

Utilization of government programs, and effective tax planning strategies, should be a priority for smaller and growing F&B companies as an additional source of funding.

The Scientific Research and Experimental Development (SR&ED) program is a federal tax incentive program, administered by the Canada Revenue Agency (CRA), that encourages Canadian businesses of all sizes and in all sectors to conduct research and development (R&D) in Canada. It is the largest single source of federal government support for industrial R&D. The SR&ED program gives claimants cash refunds and/or tax credits for their expenditures on eligible R&D work performed in Canada.

The SR&ED program is one of the most utilized programs for the F&B industry – funding under this program can reduce operating expenditures related to activities eligible under the program by 15 to 35% under federal rates and 4.5 to 37.5% under provincial rates.

An effective SR&ED strategy comprises the following:

- Participation of an external qualified SR&ED consultant to achieve a better understanding and provide ongoing updates of the program rules and regulations, identifying eligible SR&ED activities and maximizing expenditures claimed
- Designation of an internal SR&ED champion to proactively identify and document eligible SR&ED claims
- Incremental modification of existing information systems and processes to facilitate the preparation and defence of the SR&ED claim
- Formalization of a corporate strategy to focus R&D activities and align them with SR&ED projects
- Distribution of benefits from successful SR&ED claims back to the departments and divisions involved in the claim

Embracing sustainability can also provide financial benefits – we are seeing increased numbers of green initiatives that are qualifying under government tax credits, grants and other incentives. The Canada Business Network⁹ provides financial assistance programs to businesses to help make their operations more environmentally friendly and more energy efficient under the category of “funding and incentive programs for greening your business”. Most notable are the following programs:

- Farm Credit Canada Products and Services – Access capital for your farming or agri-business operations
- AgriProcessing Initiative – If you are a Canadian processor of agricultural products, you could receive money for new machinery to help you update your manufacturing processes
- AgriInnovation Program - five year program supporting the industry-led research and development stream, and the enabling commercialization and adoption stream
- Western Innovation Initiative - offers funding to SMEs in Western Canada to move their new and innovative technologies from the later stages of research and development to the marketplace
- Canada Small Business Financing Program – Access funds for your small business with the help of this loan guarantee program
- Canadian Industry Program for Energy Conservation – Access financial assistance, workshops and other services that can help your industrial facility save energy
- Coast Opportunity Funds; Economic Development Fund – Obtain funding for your sustainable business or economic development activities if you are a participating First Nation (or an individual member of one) in BC
- Product Incentive Program – Provides financial incentives to help you replace old, inefficient technologies with new, energy-efficient products

Funding programs are readily available through the government and various associations; the trick is having an approach for accessing and utilizing these programs to your advantage.

⁹canadabusiness.ca/eng/page/2815/



Brain Food

BC:

- Have you performed sufficient research into the government programs, in particular the SR&ED program, to understand how your company can benefit?
- Do you have a system in place to ensure you are staying up-to-date with the programs available in BC?

“We were able to take a flyer on expanding into Korea due to the government’s support. This made it easier for us to take a risk. There are a lot of opportunities to grow/export to underserved markets in Asia.”

Chris Merry, President, The Chai Company



Concluding remarks

Given the dramatically changing trends in health and nutrition for the general public, Deloitte sought to understand how food and beverage companies across the Pacific Northwest region are responding. Specifically, we asked you how your strategy, capabilities and financials are being structured to support your business in creating and executing sustainable, profitable strategies.

The integration of strategy, capabilities and financials has a profound effect on all aspects of the food and beverage business in the Pacific Northwest. This topic of discussion with food and beverage companies in Vancouver, Seattle, Portland and San Francisco unveiled some interesting and innovative approaches to advancing a company's strategy, capabilities and financial position, and there were lessons to be learned from the executives we spoke to.

Strategies have transformed and converged upon authentic and locally sourced products to meet consumer demand for quality ingredients and a sustainable business profile. Passion and entrepreneurialism in the workforce, in particular with sales and marketing staff, are allowing companies to differentiate themselves from their competitors. And consistent messaging and grassroots marketing methods ensure consumer loyalty and price premium approval. Yet within this revolution of mindset and approach, the importance of securing the right level and source of financing is habitually misjudged.

And so we leave you with some final questions to whet your entrepreneurial appetite and to test whether your business is truly aligned in its strategy, capabilities and financial positioning:



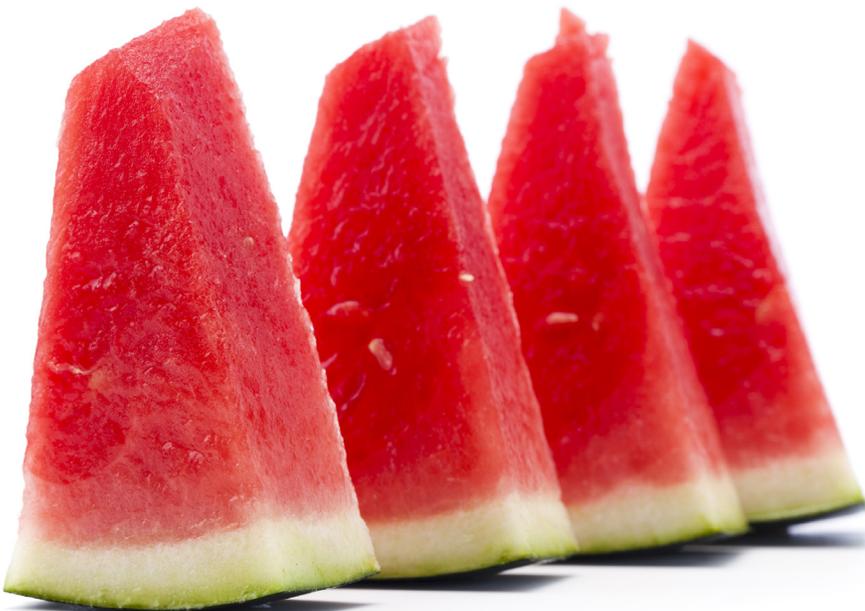
Are you successfully and consistently incorporating your core competencies, alongside sustainable business practices, into your brand, your product, your people and your operations?



Are you utilizing the best practices, executed by the best people, to understand what your consumers want and to communicate how your product meets their demands?



Is your financial structure evolving and maturing in a way that will meet your capital needs and support growth in both the short term and the long term?



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