

# The Food and Beverage Industry in Los Angeles

## A Roundtable Discussion



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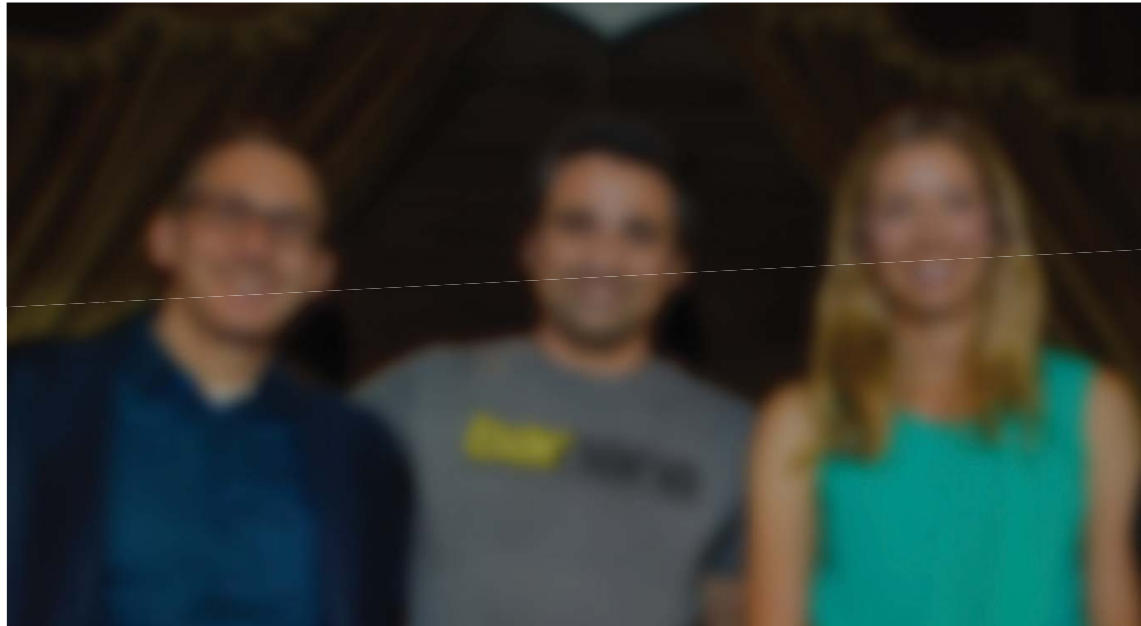


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**T**HE food and beverage industry as a whole is unique in many ways – and here in Los Angeles, where we have some of the best dining and food-for-purchase options in the nation, there’s perhaps an even more finely tuned set of rules for success. Stir in an unpredictable economy and unique regulatory conditions and you’ve got a sector of Southern California business that continues to evolve as swiftly as any other.

To make some sense of this exciting and unpredictable realm, the Los Angeles Business Journal has once again turned to some of the leading experts in the region to get their diverse insights and assessments regarding the current state of the industry that Angelenos most certainly couldn’t live without!



# Green Hasson Janks



*Great things happen when people collaborate*



**Don Snyder**  
Partner, Green Hasson Janks

**Caue Suplicy**  
Founder and CEO, Barnana

**Amelia Winslow**  
Director of Operations,  
Health-Ade Kombucha

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Food and Beverage  
Businesses to  
#BeMore**

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## FOOD &amp; BEVERAGE ROUNDTABLE

◆ **What elements are driving innovation in the food and beverage industry today?**

**SNYDER:** Consumer demand for new products is the primary driver for food and beverage innovation. For example, over the past few years we have seen the healthy foods movement pushing companies to come out with products that are gluten free, organic, no preservatives and much more. Whole product lines are being created, while others are fading. Food and beverage companies that want to succeed will need to listen to their customers and continue to innovate.

◆ **Why are food and agribusiness companies investing in technology more than ever before?**

**SURUKI-CARMANY:** The agtech investment landscape has exploded over the last decade, from a niche, opportunistic clade of the venture capital investment class, to a legitimate asset class attracting focused and generalist funds with dedicated agtech investment allocations. Changes in the global landscape of agricultural production and consumption are leading to the shifting landscape of investments in public and private R&D in the US and worldwide. Technology innovation is being sparked by changes in the population, a reduction or reallocation in the labor force, increased food safety safeguards, as well as the desire to gain a competitive edge. It is being applied to nearly every crop in every sector of the industry. Automation is set to be another big deal in 2018, as labor costs and shortages drive high-value ag producers to seek solutions to harvesting, weeding and crop protection.

◆ **What are different ways customer demands are shaping industry trends?**

**SNYDER:** I am seeing quite a bit of change in store layouts, which affects what food and beverage companies are placing in stores. The centers of grocery stores have been traditionally stocked with things like soft goods, packaged goods and canned goods, which are lower margin. To grow, stores have been making changes in the peripheries. That is where the fresher and more impulse-driven purchases are made, and they can be significantly more profitable. Part of that is the “grab and go” concept of complete meals or meal kits. Consumers want to spend less time in stores, and they want to spend less time cooking. Stores are also putting healthier foods like kombucha and fortified waters on the periphery. All of these products are higher margin, so smart companies are using it to their advantage.

◆ **How has the e-commerce revolution and digital marketplace, such as Amazon, impacted the food and beverage industry?**

**SURUKI-CARMANY:** E-commerce is disrupting the entire food supply chain. Including but not limited to how people market their food product, sell it, and how the consumer buys it. Amazon believes that the future of grocery (well, let’s be honest, all shopping) is online. Small and mid-size food company clients can sell direct to consumer by bypassing the distributor. Increasing their brand recognition, implement near immediate product improvement through Amazon ratings, as well as launch new products based on evolving consumer needs and expressed wants. This kind of connectivity and access to buyer data used to take years to compile and months to interpret, now it’s simply a click away as an Amazon seller.

**SNYDER:** The Amazon acquisition of Whole Foods is a game-changer, but it may not lead to the end of brick and mortar operations. There will be changes, however. The grab and go concept should only increase, as Generation Y and Generation Z consumers start to dominate the market. I am also seeing stores start to sell more non-food items as a way to diversify — they are realizing that in order to compete with Amazon, they have to expand their thinking. On the down side, there have also been some notable bankruptcies of chains like Tops and Winn-Dixie’s parent company, so industry consolidation seems inevitable. All in all, the future looks bright as long as food and beverage companies listen to their consumers and continue to innovate.

**WEINSTEIN:** As a result of the explosion in e-commerce and the digital marketplace, consumers expect easy access to accurate information regarding food and beverage products such as nutritional labels and sourcing as well quick delivery of meals and groceries. E-commerce platforms are responsible for

36% of specialty and beverage sales (according to the *Boston Business Journal*), and this amount will grow. Traditionally, consumers have been reluctant to buy online perishable food. Amazon is trying to change consumers’ grocery shopping habits by offering Amazon Fresh, which delivers groceries ordered online to the consumer’s home for a monthly subscription fee with a Prime membership. Amazon has the largest share of the online grocery market, and its acquisition of Whole Foods is enabling it to gain market share by cutting prices and expanding its home delivery service.

◆ **What role is social media playing in food and beverage innovation?**

**SNYDER:** Social media has gotten sophisticated. It started with Yelp — for good or for bad, restaurants have had to respond to platforms that trumpet consumer opinions. On the bright side, consumers now have a direct line to every aspect of the food and beverage industry and can heavily influence new products. Social media also helps companies understand the needs of their customers, and data analytics helps them make more informed decisions about new products and services.

◆ **How are companies leveraging technology to innovate?**

**WEINSTEIN:** Technology is key for the restaurant sector. Consumers demand technology to order online, customize product orders and select the delivery method. Technology drives the guest experience and growth. Tabletop platform ordering and kiosks are more prevalent. Technology synchronizes food delivery through onsite, take-out, catering, and off-premises delivery. Technology drives consumer personal data collection, employee scheduling, front and back of the house preparation, and handling of food orders, all impacting guest service. This requires that restaurants must adopt comprehensive cyber security policies and procedures to evidence due care for customer data. Technology connects every component of operations in order to increase speed, improve consistency, provide real-time visibility into business operations, and respond more quickly to customers. Customers use smart phone apps to engage brands and make purchase decisions. Restaurants can tailor messages to each channel, such as Twitter, Facebook, Instagram, and YouTube, so that customers engage socially on different platforms, and enjoy a better online experience. Apps have been created to allow customers to pre-order and drink/dine onsite, all of which will drive throughput efficiency and table turnover.

**SNYDER:** One of the ways food and beverage companies are innovating is with advancement of their machinery and equipment. The new tax reform act has helped push this with additional tax advantages. For example, companies can take a one-time expense rather than depreciating a new piece of machinery. That puts extra cash in their pocket, which can be deployed for more innovation. It can also reduce labor costs because some of the investment in new machinery can automate processes.

◆ **Have there been changes in how people are consuming their food in recent times?**

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DONALD SNYDER



**SURUKI-CARMANY:** Today’s consumers aren’t pulling out their grandmother’s cookbooks. They are seeking connectivity and experience while getting whole nutrition, pre-measured ingredients, directions and expected outcomes delivered to their doorstep. It’s worth the cost to DINKs (dual income, no kids) households, the fastest growing demographic set in the US today. Meal delivery kits like Blue Apron and other pre-packed meal sets sold in traditional grocery stores are capitalizing on this trend. Whole ingredient convenience foods like bars, snack balls, and other take along items are also in demand. People also want to get more out of something that they already enjoy daily, like coffee. Enter a new way of drinking coffee with an added supplement or superfood, like Bulletproof.

**SNYDER:** Over 80 percent of all consumers eat their food at home, but it does not mean they are making their food at home. They could be ordering meal kits from Blue Apron, buying meal kits at grocery stores, getting restaurant delivery or picking up meals at fast food restaurants. The trend is pretty clear — fine dining is down, casual dining is down and fast food restaurants are up.

◆ **Has there been a shift in how food businesses today handle gratuities and service charges?**

**WEINSTEIN:** Restaurant owners must be vigilant about complying with complicated gratuity and service charge regulations. Fixed or mandatory gratuities impact overtime calculations for the servers. Restaurants located in California cannot require servers to share tips or tip pooling with back of the house employees. In response, some restaurants have increased menu prices and eliminated tipping, although that practice has not gained widespread support among consumers or restaurant employees. In an effort to reduce pay disparity between servers and cooks, other restaurants have added a “surcharge” line item to distribute to all employees. Although current law does not allow California employers to “credit” an employee’s tips toward hourly minimum wage requirements, the recent minimum wage increases may encourage a renewed push for tip credits. I expect gratuities and service charge practices to continue to evolve as restaurants and other retail food businesses grapple with balancing consumer satisfaction and employee incentives.

◆ **What can food and beverage companies do right now to increase their sustainability efforts?**

**SNYDER:** There are a number of things food and beverage companies can do right now:

- Look at reducing waste throughout the supply chain
- Reduce your carbon footprint
- Advocate for sustainability in the industry
- Get a third party to measure greenhouse gases and identify where you can make changes
- Reduce packaging materials as much as possible, especially plastic
- Install solar panels
- Compost and recycle
- Donate food waste to local charities



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## FOOD &amp; BEVERAGE ROUNDTABLE

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**WEINSTEIN:** Consumers demand companies that recognize the importance of balancing profit-making activities with action that benefits society. By visibly supporting founders of social initiatives, companies often increase brand recognition and desired consumer loyalty. Companies focus on several areas of social responsibility such as becoming more energy efficient, reducing the carbon footprint, and creating a healthier environment. Savvy consumers expect companies to search for ingredients that are grown and produced in a manner that is environmentally friendly, qualify as organic, or use materials in site design that minimize energy usage and maximize equipment efficiency. Sustainability efforts when coupled with use of targeted social media can become a differentiator in the marketplace for companies to build loyalty and a sense of community.

◆ **Considering costs and raw material sourcing, what is the impact on revenue from sustainable practices?**

**SNYDER:** Some companies, such as those that are founded on a sustainability strategy, owe their revenues to being socially conscious. An example is Barnana, a company that takes so-called “ugly fruit” that would be normally thrown away and transforms it into nutritious banana-based snacks. They even use the peels by turning them into fuel pellets. In addition, more and more consumers seek out products that are sustainable and are willing to pay more in many cases. Also many sustainability measures like water reclamation, solar or wind power or a reduced carbon footprint have advantages beyond attracting conscious consumers. These measures will also reduce expenses – which translate into higher profits.

**WEINSTEIN:** A few years ago, the cost to companies of producing or using products certified as organic was incrementally higher. The cost differential and raw material sourcing for organic products have seen decreases because of the increased availability of those products and the recognition by growers and producers that consumer demand is here to stay for organic and natural products. Data shows that consumer expectation and demand has been increasing at rates that exceed raw material cost increases. Consumers’ awareness of organic products and a focus on social responsibility play an important role in incentivizing companies to engage in sustainable practices.

◆ **How important has “labeling” become today in the food and beverage industry?**

**SURUKI-CARMANY:** A mislabeled food product is just asking for a class action lawsuit. Every ingredient listed needs to be spelled out, clear as day. In addition to ingredients, other misnomers can be found when a product is labeled all natural or organic. A food producer needs to adhere to the FDA definition of all natural meaning that their product contains nothing artificial or synthetic (including all color additives regardless of source) has been included in, or has been added to, a food that would not normally be expected to be in the food. With organic labeling, there can be varying percentages of organic ingredients included in a food product. These percentages will dictate the language on the package – organic, made with organic ingredients, etc. Organic labeling is monitored by the USDA and enforced by state inspectors. Organic ingredients must be certified organic and processor must be certified organic.

**WEINSTEIN:** The FDA requires companies to properly label their products for consumer information and safety. Complying with FDA regulations is not just a legal requirement; it is a necessity to build consumer trust and loyalty. “Labeling” can differentiate a product by emphasizing who made the product. Consumers then spend more time connecting with that food or beverage, leading to consumer loyalty and increased revenue. A combination of colors, descriptions, and imagery are used to attract attention to the product and, if successful, to evoke a positive feeling around the consumption of the brand. We are seeing more companies using intricate labels to market and differentiate themselves from competitors. Smart companies, in their infancy, will often file trademark registrations in several classes to boost future brand recognition and combat infringement.

**SNYDER:** Consumers read labels. This has slowly built over time, and many people make their purchases based more on ingredients, growing conditions or manufacturing processes than price (to an extent). For food and beverage companies,

it is important to have solid values and produce something you can be proud of in the marketplace. If a consumer has a choice of two products and the label on one says their product is organic or their packaging is zero-waste vs. another product, they will often choose the socially responsible one. The same goes for labeling, such as “organic,” that is perceived as healthier along with being socially responsible.

◆ **What are the main challenges and opportunities facing food and beverage companies doing business in California compared to other states?**

**WEINSTEIN:** Minimum wage increases rank high on the list of challenges for restaurants. The local hourly wage rate already increased to \$13.25 as of July 1st and will rise to \$15.00 by July 1, 2020, creating an incentive for restaurants to reduce hiring unskilled labor while exploring the use of robots. The shrinking labor pool and increased wages encourage the use of automation to handle drudgework. Automation improves consistency, shaves time off tasks, and may help ease the incessant turnover that adversely impacts productivity and staffing. Another challenge for restaurants is meeting the expectation of consumers that take-out and home delivery orders must be the same quality as the onsite food experience. Restaurants must meet this challenge without disrupting customers’ onsite dining experience. To protect their brand, restaurants need to monitor their own delivery service as well as third party services to insure reasonable delivery time and execution of delivery.

◆ **How can a food and beverage company prepare for an investment by private equity?**

**SURUKI-CARMANY:** You can’t be too prepared when seeking an investing business partner. It’s important to spend time on your sell-side due diligence. This helps increase the probability the sale of a business will be successful. Performed correctly, the process uncovers opportunities for sellers to enhance their company’s value prior to a sale while helping facilitate a faster close time. In the food, beverage, agribusiness, and related sectors—where there’s heightened M&A activity and intense competition for growth—companies contemplating a sale can often benefit from leveraging sell-side due diligence to advance their strategic goals. In addition to sell-side due diligence - it’s important to have a strong market position, a strong management team, sustainable competitive advantages, multiple avenues of growth, stable cash flow and a strong QOE, low capital expenditure requirements, could benefit from industry tech trends, and an added bonus is that they’re open to the value that an investor can bring.

◆ **How often should companies in the food and beverage industry assess their business valuation and why?**

**WEINSTEIN:** Food and beverage companies should assess their business valuation for several reasons. When a company plans to issue shares or stock options to directors, employees and consultants, setting the fair market value of the underlying equity is key for satisfying Rule 409A requirements. The Rule 409A fair market value determination is usually performed by

an experienced independent valuation firm to support that determination. The valuation is needed to make sure the company is not issuing “cheap stock” creating unfavorable tax consequences for the recipient by resulting in income recognition plus a 20% penalty. Companies that regularly issue stock options and stock awards usually have to perform a business valuation once per year unless a material change in the business may impact the valuation, positively or negatively. A valuation assessment is beneficial when the company decides to raise capital by the sale of equity or assets, or if the equity holders desire to sell their equity for a liquidity event.

**SURUKI-CARMANY:** Companies seek clarity about fair value for a variety of reasons. Whatever the motivation, we believe valuations are fundamentally a process for informing the decisions you make with what is likely your most significant financial asset. Depending on your reason you may seek a business valuation when considering a merger, acquisition, or divestment. It’s also important when planning for gift and estate taxes, ESOP shareholder earnings, trademarks, as well as partner or shareholder admissions. It’s also an important part of fairly resolving business disputes like litigation and dissolution. Reviewing your valuation position every 12-18 months is suggested in times of high revenue growth or when seeking an outside investment. Outside investors, like private equity firms, will likely assess your valuations frequently throughout their investment term.

◆ **What advice would you offer to an early stage restaurant company seeking growth capital in 2017?**

**WEINSTEIN:** Start by answering four questions: (1) do you have an advanced business plan with evidence of building your brand and customer base and meeting financial goals; (2) how much money do you need; (3) do you want to raise debt or equity or a combination; and (4) do you have a plan to make contacts with financing sources. Typically, family and friends provide initial capital or loans. Although traditional bank loans will not be available, angel investors may be willing to consider a preferred equity investment or a SAFE investment that converts into common equity at a discount upon a qualified financing. Equipment financing, inventory financing and working capital loans can be accessed through short-term loans or a line of credit, typically requiring founder guarantees. Owners also should explore real estate backed SBA loans. With respect to food and beverage products, innovators may access capital through revenue accelerators that are eager to nurture and scale disruptive new product brands. An impressive new entry is hot-avocado sauce made by Kumana, a recent selection by the KraftHeinz Springboard Incubator Program.

◆ **At what stage is a restaurant company ready for venture capital or private equity funding and how does it attract the interest of such investors?**

**WEINSTEIN:** The restaurant must have experienced management in all critical functions, and a solid business plan stating its future growth strategy. Key factors driving investor interest include implementation of technology (front-of-house and back-of-house), quality food, service, convenience and experienced management together with a scalable concept and a



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JOEL WEINSTEIN

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CAROL SURUKI-CARMANY



**WEINSTEIN:** The start-up must: (1) make sure that its products and supply sources comply with the Food Safety Modernization Act, which governs preventive controls for human and animal food, produce safety, and foreign supplier verification programs; (2) select the type of business entity and comply with formation and filing requirements; (3) require its employees and consultants to sign a confidentiality and inventions assignment agreement; (4) assure proper classification of employees as exempt or non-exempt; and (5) protect its intellectual property and brand by retaining IP counsel to conduct a trademark search, followed by trademark registration in at least one class of goods or services. Once the company's website is operational and collecting personal information, California law requires posting a privacy policy, and having a cyber security plan is critical.

◆ **What is a good piece of advice you would share with an entrepreneur entering the food and beverage industry for the first time?**

**SNYDER:** Start with defining your values and build them into your business plan. In California, especially, value-based companies attract value-based customers who are willing to pay more for products that reflect their beliefs. This is a rising market segment, and it has a promising future.

**SURUKI-CARMANY:** Starting with a great product is key to any successful business. But first, I suggest learning everything you can about the industry, the category you are entering, and any potential competitors. I'd also suggest reaching out to key members of the industry that you admire to gain insight and fresh perspectives. It's also vital to a growing business that you develop an articulate business plan that forecasts your growth plans and how you'll achieve them. Check in on your plan, make changes and pivot as necessary. As you are building your brand, align yourself with your brand proponents and evangelicals. Seek out and create a Board of directors that believes in you, your product, and supports and challenges your goals. Never compromise on quality and stand by your brand promise as you grow.

differentiating mission statement. Visibility on social media platforms and access to influencers play a role in accessing funding. The more you know about the habits of your customers, the better the opportunity to improve revenue. Also, founders should network with the investment community by attending industry conferences. Venture capital and private equity firms including family offices, consider the number of stores and EBITDA. They typically look for at least 7-10 sites for proof of scalability and profitability, although I have a client with four sites in a growing cuisine segment that has attracted strong PE interest.

◆ **How is food safety impacting the food and beverage industry?**

**SURUKI-CARMANY:** Food safety, and violators of it, is in the

news almost daily. The effects of an outbreak can be deadly to the food processor that was involved. The most prepared companies have a strong plan in place prior to a recall. Confirm that you have strong records and documentation for each product line and batch; regularly review your recall preparedness plan; additionally, read through your recall insurance and understand what it covers and what it doesn't cover, then make updates or get additional coverage as needed. It's important to regularly assess your exposure areas and consider how prepared you are should a recall occur.

◆ **What are the most critical legal issues that a new start-up food/beverage company should allocate its limited resources to addressing at the very beginning, and what items can wait a while until additional funds have been secured?**

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