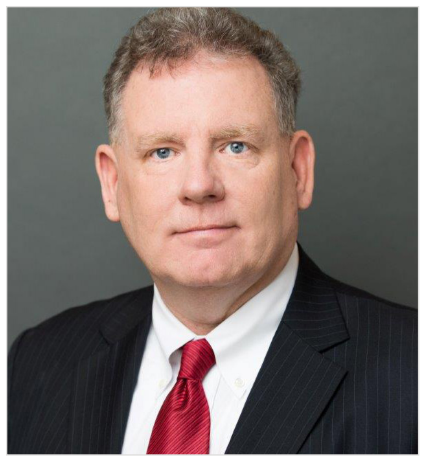
How the Food & Beverage Industry Can Find Opportunity in Disruption

BRUCE F. BRONSTER
Partner
bbronster@windelsmarx.com
212-237-1067
WINDELS MARX | Windels Marx Lane & Mittendorf, LLP

THOMAS G. CARLEY
Business Banking Regional Manager
thomas.g.carley@baml.com
646-855-2807
Bank of America Merrill Lynch

J. GRADY COLIN
Vice President Hotel Operations for Morris Moinian's Fortuna Realty Group
gcolin@gchotel.com
516-877-9372
THE GARDEN CITY HOTEL

HOWARD DORMAN, CPA
Partner, Practice Leader, Food & Beverage Sector
howard.dorman@mazarsusa.com
732-205-2040
MAZARS
ACCOUNTING | TAX | CONSULTING

The food and beverage industry is in a time of immense transformation. Many players have had to raise their game to keep up with trends like greater transparency in ingredient lists and a higher demand for authenticity and sustainable sourcing, along with a push to reduce food waste and the rise of scrappy startup brands—and their acquisitions by big companies looking for an edge.

In New York City, a culinary mecca, the bar is even higher. Fortunately, the changes sweeping the industry are bringing opportunities to many firms.

The numbers tell the story: specialty food sales in the U.S. rose to $140.3 million, up 11% from 2015 to 2017, according to figures from the Specialty Food Association. Restaurant industry sales hit $798.7 billion in 2017, up from $586.7 billion in 2010, after years of steady growth, the National Restaurant Association reported. The grocery store industry saw revenue reach $641 billion in 2017, up from $520.75 million in 2010, market research portal Statista found.

So how can food and beverage companies continue to ride the waves of change in the industry? *Crain's* recently spoke with leading experts to gather their insights on what's going on and what's ahead.

The lineup included:

- Bruce F. Bronster, a partner in the New York office of Windels Marx Lane & Mittendorf LLP, a full-service law firm headquartered in New York City. He represents high-profile hospitality groups, restaurants, celebrity chefs, investors and personalities, food purveyors and distributors.
- Thomas G. Carley, Business Banking regional manager for Bank of America Merrill Lynch in metropolitan New York. He oversees business banking teams that serve small and midsize companies throughout the five boroughs and Westchester and Rockland counties.
- J. Grady Colin, vice president of hotel operations for Morris Moinian's Fortuna Realty Group, which recently acquired the Garden City Hotel on Long Island.
- Howard Dorman, CPA, partner at accounting firm Mazars USA LLP. He delivers accounting, tax and consulting services to manufacturing and distribution companies, with an emphasis on the food and beverage industry.

Here's their take on some key trends affecting food and beverage companies in New York City and across the country.

***Crain's*: There has been a lot of disruption in the food and beverage space. What is causing it?**

Dorman: I would like to get away from calling it disruption, but rather consider it to be innovation. Innovation comes about from change, transformation or a breakthrough—a new method or idea. If you look at one company everyone considers to be the biggest disrupter, Amazon, what has it really done? Amazon created a new shopping portal for a consumer who wants whatever they purchase now. The acquisition of Whole Foods just expands their distribution network and increases their product selection. And everyone has followed them. Walmart bought Jet.com in 2016.

Carley: More than ever, consumers, particularly the younger generations, want to be associated with newer, more authentic brands. As a result, smaller companies that previously held only a very small niche in the marketplace have now caught the attention of the consumer and, more to the point, the consumer's wallet. This has made the traditional, larger companies take notice—so much so that the bigger companies want to bring these 'disruptors' under their umbrella and reap the benefits. Many of these newer companies are producing products that are healthier to consume and also have stronger environmental, social and governance

Partner at Windels Marx Lane & Mittendorf LLP

"The root of the recent disruption boils down to intense competition. The restaurant industry is facing unprecedented pressures to offer not only exceptional food but also a unique consumer experience."

BRUCE F. BRONSTER

WINDELS MARX | Windels Marx Lane & Mittendorf, LLP

principals, providing even greater attraction to both consumers and acquiring companies alike.

Bronster: The root of the recent disruption boils down to intense competition. The restaurant industry is facing unprecedented pressures to offer not only exceptional food but also a unique consumer experience. In New York City, there are 24,000 food establishments, and most serve high-quality food. There's a proliferation of excellence, though the experiential aspect has changed. For example, architectural elements of restaurants may play an important role for a diner looking for fine cuisine amid great architecture for the ultimate dining experience.

The offerings in New York are incredibly diverse. Many different companies want to upgrade their offerings by expanding in different ways. This shift to focusing beyond the quality of the food to the experiential aspect impacts and adds costs to the already fickle restaurant industry.

***Crain's*: What forthcoming changes in the industry do you see impacting food and beverage companies the most as they relate to consumers?**

Carley: The changing of food label requirements. Consumers in general, and particularly food buyers, are becoming more conscious of where a product is produced, its ingredients, where those ingredients are sourced, etc. With consumers being as health-conscious as ever, having better insight into the makeup of their food—with an emphasis on truer serving sizes, calories, and added sugars—will have a greater influence on their buying decisions than ever before.

Colin: Creating memorable experiences, and exceeding expectations is key. No matter the price point, guests must feel good about what they have spent on the experience. When ambience, gracious service, well-crafted food and drink all come together to surprise and delight the guest a memorable experience is created that in turn equates to return visits.

Bronster: Food and beverage companies are increasingly trying to micro-divide categories to find a specific niche and fill it. For example, there are now dozens of teas, kombucha brands, and every sort of juice known to mankind. Food and beverage companies are micro-slicing and micro-dicing the market to sell more to consumers, and marketing and distribution channels are changing to get closer to them.

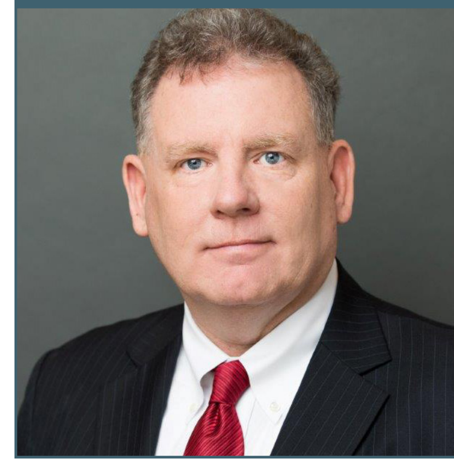
Dorman: It is obvious that the health and wellness space continues to grow. Consumer food preferences reflect shifts in eating habits, cravings for new flavors (savory, spicy) as well as convenience, freshness and localness. Consumers now expect more from their snacks, requiring them to provide a wide range of health benefits, like strength and energy. We are seeing a sharp rise in private label brands because the new consumer has lost trust in the big brands and finds that the private label brands promote the values they are looking for. I was so surprised to hear that Unilever has over 600 brands but only 20 to 25 make up a majority of their sales and profitability. Why? Trust. People trust specific brands.

***Crain's*: What challenges do you see for the food and beverage industry in the future?**

Colin: There are several factors that will challenge the future of the food and beverage industry, from the rising costs of food and real estate to increased wages.

Bronster: The recent increase of the minimum wage is huge and really hit the restaurant industry hard—right in the bottom line. In New York City, the minimum wage for employers with 10 or fewer workers rose to $12 from $10.50; and for employers with 11 or more workers, it will be $13 per hour, up from $11. The rest of the state now has a minimum wage of $10.40, up from $9.70. In an industry with such slim margins and a labor-intensive workforce, the impact is a significant concern. The intent of the minimum wage increase was to affect the back of the house, though the reality is it has touched the front of the house. Now restaurants must sustain the additional cost.

Business Banking Regional Manager for Bank of America Merrill Lynch in metropolitan New York



"Once established, companies will be held more accountable for how they operate responsibly. This includes establishing and promoting policies to ethically source ingredients, minimize food waste and maintain transparency in their overall operations."

THOMAS G. CARLEY

Bank of America Merrill Lynch

Carley: First and foremost, in a world where consumers are more knowledgeable than ever, a food and beverage company will find it more challenging to establish and then sustain its specialty. As trends quickly come and go due to the ease by which prospective buyers can be touched, understanding and effectively using social media as a marketing/sales tool will be a must.

Once established, companies will be held more accountable for how they operate responsibly. This includes establishing and promoting policies to ethically source ingredients, minimize food waste and maintain transparency in their overall operations. Regarding ingredients, establishing proper supply chains that are cost-effective has always been, and will always be, a challenge for companies in this industry.

Dorman: There will always be change in the way food is produced, sold and consumed. I want to keep our future environmental challenges out of this discussion, even though that will be the number one challenge in the years to come, because that would take a whole article by itself.

Consumers drive change. So how does the supply chain stay in front of it? I think transparency in the supply chain will be a very big issue. The large consumer packaged goods companies (CPGs) are addressing that. Tyson made a large investment in technology that will provide the consumer with full transparency as to where the product was made. In retail, convenience stores are becoming mini-markets. Most drug store chains sell fresh and on-the-go food. What will be the fate of our treasured supermarkets? How will they innovate?

***Crain's*: As companies seek to produce food that is sustainably harvested and/or manufactured, and consumers seek to consume it, have you seen a change in how small to mid-size companies do business or build their supply chain?**

Bronster: If the world stopped producing food this minute, we would have a 23-day supply. Everything we eat is farm-to-table. It's a question of access, transportation, timing and supply. Maybe the trend should be aptly named 'local farm to table.' The trend is huge, and there has been a measurable change in how the industry is adapting. Certain entities vertically integrate their sourcing. A restaurant, for example, may buy or partner with a dairy farm, so you can see how sourcing has changed from more traditional methods.

***Crain's*: How have the 2017 tax law changes affected your clients and other companies in the food and beverage space?**

Colin: We've noticed a resurgence in spending and increased budgets from our corporate clients. For example, we are getting more inquiries and bookings for corporate holiday events. Our clients are also requesting more than the venue, food and beverage. With an increased budget, they are able to spend more and are adding customized experiences to their events.

Dorman: We've seen a positive impact in our portfolio. You have to consider though, in order to capitalize on these tax law changes, the company must be in a good position already, whether it is a matter of profitability or a very strong balance sheet. We have seen an increase in the investment in capital equipment and facility upgrades, which, if planned properly, will yield benefits in depreciation, which can shield a company from paying income taxes for a certain period of time. We have seen in the supermarket space stores being built and rehabilitated to take advantage of these tax changes. Under certain circumstances you will see companies paying lower taxes on their profits due to reduced tax rates, and we are seeing some of these savings being reinvested into the company by adding employees or providing the current employees with bonuses. I recommend that before you undertake any significant investments in your company that you consult with your financial partners.

Bronster: Companies have taken a hit in unexpected areas, such as sporting events. Luxury boxes used to be 50 percent deductible, and now there's zero deductibility. Practically speaking, if you have a box at Yankee Stadium that

Vice President Hotel Operations for Morris Moinian's Fortuna Realty Group

"No matter the price point, guests must feel good about what they have spent on the experience. When the ambience, gracious service, well-crafted food and drink all come together to surprise and delight the guest a memorable experience is created that in turn equates to return visits."

J. GRADY COLIN

THE GARDEN CITY HOTEL

costs $10,000 with food costing $2,500 for each event, that's a significant cost for an industry where margins are notoriously slim.

***Crain's*: How has the emergence of smaller/up-and-coming food companies impacted the food and beverage industry?**

Bronster: Consumers are way more sophisticated in tastes and have unprecedented access to food via the internet and delivery options. Lots of micro-companies are emerging, which leads to a new source of competition for traditional companies to reach and retain clientele, especially discerning ones with high incomes. It's a lot easier to get your product to the consumer. People will have wild-caught stone crab claws FedExed from Florida.

Carley: Previously, the big food companies largely ignored these niche brands as they posed little threat to change the average food buyer's decision-making process. However, with consumer attitudes changing, large companies now want to acquire these smaller brands, not to remove them from the marketplace, but instead to promote that brand as their own. This is important because consumers, more than ever, want to be associated with brands that are authentic, 'better-for-you,' and more transparent about their social and environmental views.

Dorman: With this overwhelming surge of emerging companies comes passion. I believe the large CPGs either have lost the passion for new products or cannot keep up with the pace that the consumer is requiring when it comes to their demands—natural, organic, healthy and fresh, hyper-local. Many of the CPGs have created incubators and accelerators whereby through their venture capital divisions they look to these emerging companies for new products to fill their shelves. Small investments can help small companies go to market; larger investments are used to establish new products across the marketplace.

Innovative ideas can replace stale brands. Look at the difficulties of Campbell's. Did they wait too long to make changes? Have their staples gone stale? Look at the turmoil that is now affecting them.

***Crain's*: With companies like Uber Eats and Grubhub growing in popularity, how do you see this affecting the industry? Will more people favor an at-home dining experience?**

Bronster: These are great services lessening the need for people to dine out. It's more economical to eat at home, though people inherently like to go out to see and be seen. It's fun, and it plays to the experiential aspect, though these services certainly make it more attractive to dine in. In addition to these services and in the larger picture, the industry is facing competition from commissaries, supermarkets, and cook-at-home delivery services, like Blue Apron. There's even a caviar service. That trend will continue, and more traditional establishments will have to further define what differentiates them in this highly competitive market.

***Crain's*: Cashless service continues to grow. What hurdles do you see in a broader adoption of the payment form?**

Dorman: There have been significant steps toward a cashless society in the past several years. I see several key issues to consider. First, an increasing worry is security and privacy concerns. Cash is anonymous, but cashless transactions leave a digital footprint. And how much security do we have in place? With new technology comes new avenues of attacks on our digital privacy and security. There will also always be people resistant to change, which is slowing this transition.

Society is certainly moving toward a cashless environment, but it is likely we will see a world in the near future where the consumer has a choice of transactions, where cash and cashless coexist.

Bronster: Cashless is here, so the discussion about hurdles is over. Cashless systems have streamlined transactions, which translates to cost savings for establishments that have eliminated the proverbial middle man, specifically employees. That's the larger trend. Employment expenses are shifting to patrons through technology. Diners can order and pay for their meals with a swipe of a credit card or mobile device. That dynamic will increase. There's also a shift on the labor side. Go to a Korean place, you can prepare your own dinner as part of the experience.

Carley: As the use of cash has decreased in the marketplace, cashless payment options have become ubiquitous. Whether using a payment gateway on an app, a digital wallet on a phone or smartwatch, or a simple credit card swipe at a terminal, there are plenty of cashless options available to accommodate most consumers from a technological perspective. However, as is often the case with most innovations and trends, younger generations are generally quicker to adapt, as older groups continue to use what is familiar. Thus, I believe, most of the hurdles that exist are simply a function of time as opposed to technological development.

Partner, Practice Leader, Food & Beverage Sector at Mazars USA LLP

"With this overwhelming surge of emerging companies comes passion. I believe the large CPGs either have lost the passion for new products or cannot keep up with the pace that the consumer is requiring when it comes to their demands–natural, organic, healthy and fresh, hyper-local."

HOWARD DORMAN, CPA

MAZARS
ACCOUNTING | TAX | CONSULTING

***Crain's*: What are factors to consider when choosing a food and beverage partner?**

Colin: Brand alignment is paramount. A potential partner must fully understand the hotel image and style in which it conducts itself. Next the partner must commit to integration so that the guest experiences similar standards of service and protocol seamlessly.

The business agreement should cover specific timelines and contingencies for all deliverables so that both parties have congruent expectations of how things will be done. Flexibility on both sides is key.

Carley: Given the dynamic nature of the food and beverage industry, it is important to have professional partners who are actively engaged, understand emerging trends, and can proactively advise a company within the industry. Companies should look for a partner with experience in working with both growing and mature food and beverage companies, who can provide industry-specific research and benchmarking tools to help make important financial decisions. Consider the cash management tools available for your business, liquidity and foreign exchange services, financing for office space, warehousing, equipment and working capital.

Bronster: One of the biggest things is reputation. When doing a deal, I repeatedly hear verbiage about the halo effect in working with celebrity chefs. It's the reality and benefit of doing business with someone who has worked long and hard in a demanding industry and has earned a sterling reputation. Pay attention to that. Word travels fast in this industry. If someone has a strong reputation, you know you won't have a delivery problem, and that can disrupt a night at any restaurant.

***Crain's*: Can the food and beverage division of a hotel or a venue truly have a significantly positive profit impact?**

Colin: Absolutely! The restaurants, lounges, bars and catered events hosted create sizzle in a hotel's identity. The right notable culinary star can bring an elevated sense of style to the hotel brand. In the case of The Garden City Hotel, Chef David Burke's cuisine has kept the dining experience evolving and interesting for our loyal guests, while also drawing in a multitude of new faces. The inherent lift with regard to culinary quality when a big-name, accomplished chef joins ranks with a luxury hotel just pushes the value way up.

Dorman: It is about the brand. If the food division delivers consistently good food, service and experience, then it can positively impact the overall operations of the facility. If the hotel holds itself out to be a destination place for vacationers or for events and has a great reputation for its food service, then the result will be positive. For example, we have had our partners retreat at a beautiful facility for the past few years, but the food service side of the event has not been good. Because of that, we have decided to change our location to accommodate the taste buds. Great location, great rooms, great golf. Lousy food. That is not acceptable today. ■