Association of Food Industries
2020 Annual Report
https://www.afius.org/page-1863126

2020: Managing Uncertainty in Volatile Times

Louis J. Biscotti
Marcum LLP

Running a business day-to-day in the F&B space is difficult enough. Regulation, globalization and taxation add a little—or a lot—more uncertainty, making managing risk an even-bigger part of managing your business. You need to analyze what you're doing right and wrong and be prepared to make adjustments. With so much change and volatility, food and beverage executives need to focus on methods to minimize and manage the risks that can derail a business. Whether it's strategy that missed the mark, cyber-attacks, product recalls, labeling issues, input price swings, economic conditions or poor employment practices, companies need to focus not only on increasing margins, income and revenue, but reducing risk.

The SWOT Team

The first thing to do is send in the SWOT team. In order to be prepared for the future, make sure you're analyzing your strengths, weaknesses, opportunities and threats in the marketplace. A SWOT analysis asks and answers a lot of questions. What are you good at? Where are you ahead of the curve and where are you falling behind? Where are you strong and doing well and where do you need to improve? Make sure you have a strategic plan not only for the current year, but for the near-term future.

And make sure that your plan is updated each year based on your SWOT performed with the key people in your organization. A SWOT analysis should look at strengths as well as weaknesses not simply in one department, but across all your business operations.

Examples of the types of results you can expect from a SWOT: Our product is No. 1 in the marketplace and our team is strong. Our finances are in a good position. We're a little weak in this geographic area. We need to step up in innovation. We have tremendous potential in plant-based foods. This means looking at what you're doing and not doing. That kind of conversation with key management helps you design and execute your strategy. Once the SWOT is completed, prioritize your action steps in each of the four areas and share the results with your team. It's been estimated that a whopping 95 percent of companies' employees don't understand the company strategy. Look at rewards and risks – and do what you can to increase the former and decrease the latter.

Captive Insurance

While a SWOT can help you become aware of and determine actions related to uncertainty, executives also can use other strategies to manage risk. One way to mitigate risk is through a captive insurance company, a self-funded insurer that any company can set up. You are permitted to pay up to $2.2 million in tax-deductible funds into your captive and use the money to pay claims and deal with issues. Think about the possibility of a product recall or a cyber-attack. You can have policies to cover those risks through a captive insurance company. Almost all Fortune 500 companies have captives and smaller companies can also take advantage of this strategy. But you need to be careful. Captives are one of the items on the IRS's "dirty dozen" list, because they've been abused. Properly structured, a captive is a wonderful way to mitigate risks in this age of cyber-attacks, recalls and adulteration.

Cybersecurity Testing

While insurance can provide protection from big problems, preventative controls and testing are critical. If cybersecurity is getting better, so are the hackers. Are you ready? One report for IBM found that nearly 80 percent of IT and security professionals didn't have a cybersecurity incident response plan. The best way to be prepared is to test how your company will respond in the event of attack. You use a fire drill to prepare for a fire. A cybersecurity drill falls into the same life-saving category. Forego one at your peril. We routinely perform cyber penetration studies at an alarmingly increasing rate. We show where the vulnerabilities are. Better to find out through a simulated test than through the real thing.

Food Safety Regulations

Companies need to be aware of and prepared for food safety regulations. And the regulations, along with the times, are changing. Under the Food Safety Modernization Act, or FSMA, signed into law in 2011, rules are continually being developed and rolled out. The Foreign Supplier Verification Program, or FSVP, which went into effect in 2017, requires U.S. importers to have proof that their foreign suppliers are manufacturing food in ways that meet U.S. standards. It’s mandatory there by documentation of all of control procedures for food safety. If you haven’t done it already, you’re late. There are strict regulations about traceability of all of ingredients that go into food and beverages. You need to know where it all comes from, its origins and contents. And you have to document that. FDA is staffing up to prepare for cracking down. Compliance is better for business and, in the long run, cheaper than ignorance.

The regulations are there to protect consumers in an age of globalization and a call for transparency. If there’s an outbreak or recall, you should be able to trace product back from the retailer to the source of origin to reveal where it came from, where it was shipped, who shipped it and in what quantities. And you must have a written hazard protection plan in place, so if there’s a recall, you are ready to take the necessary steps. In cases of gross negligence, CEOs can be held criminally liable. This goes beyond a civil penalty where they simply shut down your plant. Technology can help you with transparency and compliance. Blockchain, a shared ledger of every transaction that occurs along the path of purchased goods, can be helpful. Only the parties to the transaction can enter the information into the Blockchain ledger. No one else can alter or change this permanent record.

Labeling

You need to be very mindful of how you label your products. The term “natural” is not regulated. Not knowing or following the labeling rules can expose you to risks. What exactly does “meatless” mean? The meat industry is pushing very hard regarding labeling of plant-based products. The dairy industry is trying to protect the word “milk.” Check in with your legal advisors about appropriate labeling. There are regulations about organic products, GMOs and non-GMOs. Companies are getting letters from FDA if they claim health benefits from CBD. You must be careful how you advertise and label your products in this litigious environment. Be aware of trends emerging in food and beverage and make sure that adaptation and innovation are part of your company’s DNA. So many companies are being left behind by not being cognizant and taking advantage of the latest trends, such as plant-based, private label or new fulfillment options for online orders.

Input Volatility

The industry has seen price increases of 200 percent to 300 percent a year in certain commodities. Because of the volatility of commodity prices, it’s important to be prepared. Companies can look at forward exchange contracts and hedging. Let’s say a manufacturer buys 20 tons of sugar. If you anticipate that sugar prices will increase, lock in the prices with a forward exchange contact. If prices increase, you won't take the price hit on your end. Otherwise you'll have to absorb the hike, since you likely will not be able to pass it on to customers. The problem with a hedge is that if prices fall, you can get hurt. A prudent approach would be to hedge 50 percent of your purchases and build in a floor.

Interest Rates

There's talk of a looming recession. You need to account for that in budgeting and planning for 2020. What if we do have a recession? What would your action steps be? Because of the low interest rates that exist right now, have you looked at all your financial arrangements and loans to consider whether any of the rates you're paying can be negotiated down? And that brings us to the impending change from LIBOR to the Secured Overnight Financing Rate. It's potentially a new benchmark that will replace or at least supplement LIBOR and affect loan documents and loan arrangements. It's not due until 2021 and it's not even a definite, but companies need to become aware of it and take it into consideration. Talk to your advisors about the potential impact and how to handle the transition. If you have an existing document in place, how does that get revised? What impact will that have on your business? And what about rising interest rates? Be sure you're aware of and ready for the impact of changing rates. Be mindful of credit risks with your customers, especially in retail markets.

Tariffs, Taxes and Tax Benefits

This brings us to tariffs and overlooked tax benefits. You need to be in touch with regulatory agencies to make sure you're aware of new tariffs and incorporate those into your pricing strategies. If you were buying aluminum at $1 per can and there's a 25 percent tariff, can you pass that on to your customer? Sometimes you can't, which would impact your margins significantly. While you need to be ready for any tax increases, many companies don't avail themselves of tax benefits currently available to them, including the highly advantageous research and development tax credit. It doesn't require research and development that is new to the world, just new to your company. Any new products or processes could potentially qualify.

Retention Recipe

Low unemployment is good for the economy, but executives need to look at how it impacts their companies. Because of the present high employment level, retention programs have become more important. Do you have an effective retention program in place? What's your turnover? Lack of retention programs increases the risk of losing qualified, trained employees. Companies should be looking into employee reward programs such as pension and 401(K) plans. ESOPs (employee stock ownership plans) are becoming more common. These can be valuable tactics to put into effect when you have a retention issue.

All in all, be prepared by working on your business and not just in your business. Running a successful business is tough enough, but if you don't manage uncertainty and volatility effectively, you might not have a business to manage.

Louis Biscotti (louis.biscotti@marcumllp.com) is national leader of Marcum LLP's Food & Beverage Services group. He advises clients on growth and profitability and has guided many companies in their development from small emerging entities into multi-million-dollar organizations. Mr. Biscotti founded a series of best practice forums for food and beverage companies and publishes a monthly Food & Beverage column on Forbes.com.

Marcum LLP (www.marcumllp.com) is a national accounting and advisory services firm with offices in major business markets throughout the U.S. and select locations overseas.