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INSIGHTS

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For Food & Beverage Entrepreneurs, Financing Deals Come In More Flavors Than Just Vanilla

Q: HOW ARE EARLY STAGE FINANCING DEALS DIFFERENT IN THE FOOD & BEVERAGE (F&B) SPACE?

WILLIAM BERNAT: Unlike tech or life science, food & beverage deals tend to come in more varieties. Convertible note and preferred stock deals are still the most prevalent vehicles for investment, but it's not unusual to see early deals structured through the sale of common stock. If the company has the leverage to do it, issuing common stock to early investors allows the founders to maintain many of the controls that often get diluted in a preferred stock deal. This is often important for early stage entrepreneurs implementing their vision. Companies also more frequently remain as LLCs in early F&B deals, as opposed to converting into C-corporations as part of the transaction. Although complex, LLCs provide the most flexibility to divorce economics from control and provide the most efficiency in situations where a growing company may want to distribute profits to its members.

Q: WHY DO THESE DIFFERENCES EXIST?

WB: The breadth of deal variety stems from both the makeup of investors and the potential for a more nuanced return of investment thesis. Investors in these deals (if they aren't friends and family) are in many cases industry insiders, such as venture arms of bigger players, distributors, co-packers, other service partners or dedicated F&B angel or venture groups. Their investment thesis often differs from a tech or life science investor at a similar stage. For example, a distribution partner may be willing to buy common stock in a company that vests upon achievement of certain milestones. Similarly, a strategic partner may be willing to get in early with a purchase of common stock in a potential target company as a prelude to a future acquisition.

F&B companies tend to be less binary in their opportunities for success. In biotech, the technology either works or it doesn't, and companies are often either huge home runs or fail. Similarly, in most technology deals, because of the pace of technological innovation, companies are either successful or get quickly bypassed. In contrast, while many F&B companies can secure huge wins, many can be slower-growing highly profitable companies with a fanatical customer base. This allows companies to become profitable and offer investors the opportunity to monetize their investment through distributions in advance of an exit. F&B entrepreneurs may not always be successful in obtaining more "founder-friendly" terms, but there are opportunities for creativity in structuring.

Q: WHAT'S THE BIGGEST TAKEAWAY FOR F&B ENTREPRENEURS?

WB: Deal terms are important, but so is the fit between the company and its investors. While a founder may instinctually gravitate towards the deal with the highest possible valuation, entrepreneurs should look at the deal holistically and weigh valuation against other control features that they might be giving up as part of the transaction. Dilution isn't so bad if the investors and board members joining the company can help grow the company and increase everyone's share of the pie, especially while letting the founders steer the ship.

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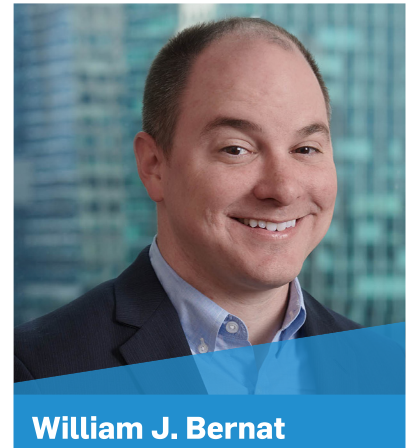

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