



Background

Minimizing Risks in the Cannabis Industry

Companies that legally grow, process and sell cannabis products share many of the same business risks with companies engaged in other agricultural commodities and consumer products. But cannabis companies also confront unique risks and challenges due to federal legality issues, popular sentiment about their product and the evolution of their relatively new industry.

In this paper, we'll explore three significant risks currently facing cannabis business leaders. We'll also present some suggested steps and best practices they can consider that can help avoid those risks or minimize their impact in order to maintain the value of their assets, maximize profits and minimize losses.

The risks and challenges discussed below are:

- + **Executive liability in decision making**
- + **Limited access to capital to evolve the business**
- + **Loss exposure due to property undervaluation**

Insurance-based risk transfer strategies are just one set of tools at their disposal.



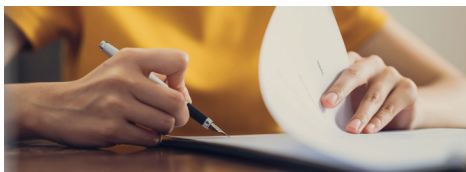
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RISK in Focus

A person wearing a blue suit jacket and blue nitrile gloves is holding a blue pen over a clipboard. The person is standing in a field of green cannabis plants. The background is slightly blurred, showing more of the field. The overall scene suggests a professional inspection or data collection in a cannabis cultivation environment.

Executive Liability in Decision Making

Hazard 1:
Executive Liability in Decision Making

The cannabis market is full of gray areas. Legal and financial matters can be confounding and seemingly contradictory. In this environment, however, cannabis business leaders are confronted with decisions about crucial day-to-day operational matters and longer-term strategic actions.

The opportunities for missteps are significant and constant. There are crucial day-to-day operational matters to get right, including those related to employment practices and personnel issues. Then there are the longer-term strategic considerations that emerge – for example scaling operations, merging with another company, selling the business or even negotiating a receivership arrangement in advance of a restructuring, since bankruptcy, with its federal Chapter 11 protection, isn't an option for this industry.

First-generation cannabis company founders and owners tended to be entrepreneurs and visionaries. But as their companies and the industry evolve from novel to mainstream, and they face those short- and long-term challenges, they'll want to form a team of industry experts in key strategic areas including personnel, legal, advocacy, finance, horticulture, risk management, strategic planning and more. The team can include:

- + Employees with functional and technical expertise**
- + Consultants who specialize in the industry**
- + Trusted service providers familiar with this space**

Maintaining appropriate levels of Employment Practice Liability and Professional Liability (Errors and Omissions) insurance coverage is another prudent element of a comprehensive approach to protect a cannabis business owner and their business from the worst results of executive-level missteps.



A hand holding a pen writing on a document, with a dark blue overlay containing text.

**Limited Access to
Capital to Evolve
the Business**



Hazard 2:

Limited Access to Capital to Evolve the Business

The cannabis industry is young, but it's maturing quickly and experiencing the kinds of growing pains one would expect as technology and markets evolve in these early stages. Even in states and localities where retail sales have been legal for several years, the cannabis economy can be in flux.

Consumption levels fell back to pre-pandemic levels in 2022 ... but not for long, with sales expected to grow by 12% in 2023.¹ Pricing is under siege in part because localized legalization didn't supplant diverted cannabis supplies or illegal sales as much as expected.² In some locations, the retail price has fallen 75% in the past two years to less than \$100 per ounce.³

Consolidating, modernizing and scaling are the common strategies to weather these trends. Most often, these require financing and access to capital. But with cannabis still considered an illegal drug under the federal Controlled Substances Act, federally insured banks are not inclined to provide financing services to cannabis-related businesses (or promote the fact that they do) for fear they'd be charged with violating federal law.

Fortunately, there are options, albeit limited ones. Regional banks and local credit unions are more likely to work with cannabis companies to offer business accounts and lines of credit. Cannabis companies looking for the ideal banking relationship will need to research these options – not only to find institutions that provide services in the first place, but to learn about their policies and requirements.

These banks will be performing a high level of due diligence on the cannabis company as well. These businesses should be prepared to share business plans, financial records, market analyses, leadership team credentials and more to demonstrate their creditworthiness.





**Loss Exposure
Due to Property
Undervaluation**

Hazard 3:

Loss Exposure Due to Property Undervaluation

Since mid-2022, undervaluation of property and assets has been a source of challenge and risk for insurance carriers and insureds in nearly all industries, including cannabis. In most cases, this underreporting by cultivators and dispensaries is inadvertent and the result of the unique economic pressure in the industry with operational costs increasing rapidly while prices are dramatically decreasing.

These days, valuations for most real estate and production assets tend to be significantly underestimated, increasing the company's risk/loss exposure. It may be impossible for a cannabis company to recover from a major loss since their valuation estimates haven't kept up with actual replacement cost values and their internal risk control efforts have been based on outdated financial data.

It's more important than ever that cannabis business leaders work with their brokerage and risk management teams to determine and utilize the replacement cost valuation methodologies insurers prefer.



Sources:

- ¹ https://www.forbes.com/sites/willyakowicz/2023/04/10/why-cannabis-jobs-are-going-up-in-smoke/?sh=c7d617e48bfb&utm_source=newsletter&utm_medium=email&utm_campaign=dailydozen&cdclid=63bf56f1f9c34d1310e5bdd8§ion=dc_s_tp
- ² <https://leafly-cms-production.imgix.net/wp-content/uploads/2022/11/04104710/Leafly-Crops-Report-2022.11.4corrected.pdf>
- ³ <https://www.politico.com/news/2022/12/25/weed-prices-business-michigan-00075485>



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