

**Deloitte.**



Driving growth and building  
trust in global markets

2020 cannabis report

The background of the page is a close-up photograph of cannabis leaves, showing their characteristic serrated edges and palmate shape. The leaves are a vibrant green color, and the lighting creates a sense of depth and texture. The overall tone is natural and organic.

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# Introduction

## Weathering the economic downturn, and preparing for the next phase of expansion

Despite nursing a bruise or two, 2020 finds the cannabis sector wiser. The industry's swift, exciting ascent reached a peak, only for missteps and investor skepticism to send the sector earthward almost as fast. Now the sector must also contend with the global COVID-19 crisis and its economic impact. Cannabis companies face uncertainty as they pick themselves up, dust themselves off, and look forward to the future. But what sort of future?

We believe the future of the cannabis sector continues to hold tremendous promise and incredible potential for growth and lasting prosperity. However, it is clear that the industry must change to realize its full potential. Its foundation must be strengthened through collaboration among industry players globally. To push through today's challenges and position itself to recover and thrive in the years to come, the cannabis industry must change course, evolve, and mature. It's a journey much like that undertaken by the technology sector after the bursting of the dot-com bubble in 2000: hype, excitement, and sky-high expectations gave way to a more focused, strategic, and professional approach to doing business.

While each cannabis company's journey will be unique, it must begin with an understanding of the current state of the industry—the gaps and opportunities as well as the risks and missteps that have caused some players to stumble. To launch the journey and move forward with confidence, we propose a three-part framework, that we'll explore in this report:



#### **Develop a strategic focus**

Cannabis companies should capitalize on their industry experience and knowledge to focus on those areas where they have a competitive advantage. This includes the consumer segments targeted, the products offered, and their place in the cannabis value chain.

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#### **Rightsize the right way**

With a strategic focus identified, companies should take action to rightsize their workforce and operations accordingly. They should also use this opportunity to move past their early entrepreneurial days and recruit experienced, professional talent across all functions of the organization to ensure they operate the business in a manner that reflects the industry's increasing maturity, so they can reasonably scale.

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#### **Prepare to expand**

Having a clear strategic focus and an agile, professional workforce in place, companies can then pursue intelligent, deliberate expansion that aligns with their long-term vision and reflects and capitalizes on emerging industry trends.

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# Shoring up the industry foundation

Industry players need to work collectively to re-establish a stronger foundation and encourage the healthy evolution of the industry.

But the onus for building a stronger cannabis industry that can recover from its early missteps can't be placed on companies alone. Governments and regulatory authorities must take steps toward standardization, and the incentivization and simplification of domestic and international commerce.

## Standardization at a global scale is required for more consistency in several key areas:

### Testing and quality standards

Testing standards need to be established regarding active ingredients (i.e., THC, and CBD); pesticide, metals, mold; and other, product-dependent characteristics. A clear, global regulatory structure also needs to be established to promote product integrity and transparency. This would include seed-to-sale information, such as country of origin; marketing certifications that list where the cannabis was cultivated and under what standards; certification for strain claims; and requirements for product packaging and labelling.

### Clear regulatory pathways for cannabis- and hemp-derived products

Cannabis companies can't afford to fly blind when developing products; they should instead have clear, unambiguous pathways no matter the type of product they're working on. Regulators must develop these pathways, allowing for a clear distinction between medical, recreational, and health and wellness uses, and between all product types. Compliance standards for the seed-to-sale journey should be grounded in consumer safety, and any enforcement policy should be consistent, risk-based, and promote both consumer safety and long-term public health. Regulators need to create clear pathways for research and clinical evidence so policies can be quickly refined.

Cannabis companies have been engaging in cross-border expansion opportunities since the dawn of the industry. These opportunities have great potential for scaling and growth, if supported by well-crafted government policy that can allow for a strong domestic and international supply chain to facilitate cannabis production and sales both nationally and internationally. The industry must push governments to convene and establish policies governing international cannabis trade, and work with enforcement authorities on disclosure and documentation requirements. As well, the industry must urge governments to establish economic development objectives and opportunities to support the cannabis sector.

Industry leaders must also play a role in developing a more customer-centric approach to doing business. There needs to be better alignment between cannabis companies' business strategies and their insights into current and potential customer characteristics and their behaviour. Data collection and analytics play a vital role in enabling companies to have an in-depth, forward-looking, and holistic view of the customer, and make data-driven decisions about product offerings, marketing strategies, digital channel optimization, customer experience, and more. In particular, it is critical for businesses to gain insights around current, new, and future users for the product and service categories they currently operate in or plan to expand into.

The industry is still young and full of potential. Along with the governments and regulators that oversee them, cannabis companies are learning from the missteps. We are confident they can take the actions needed to mature and move forward in this time of great uncertainty and take the sector to the next level. However, as mentioned earlier, the role of the government in establishing clear regulatory and compliance foundations is critical in enabling them to do so.



# The current state of the industry

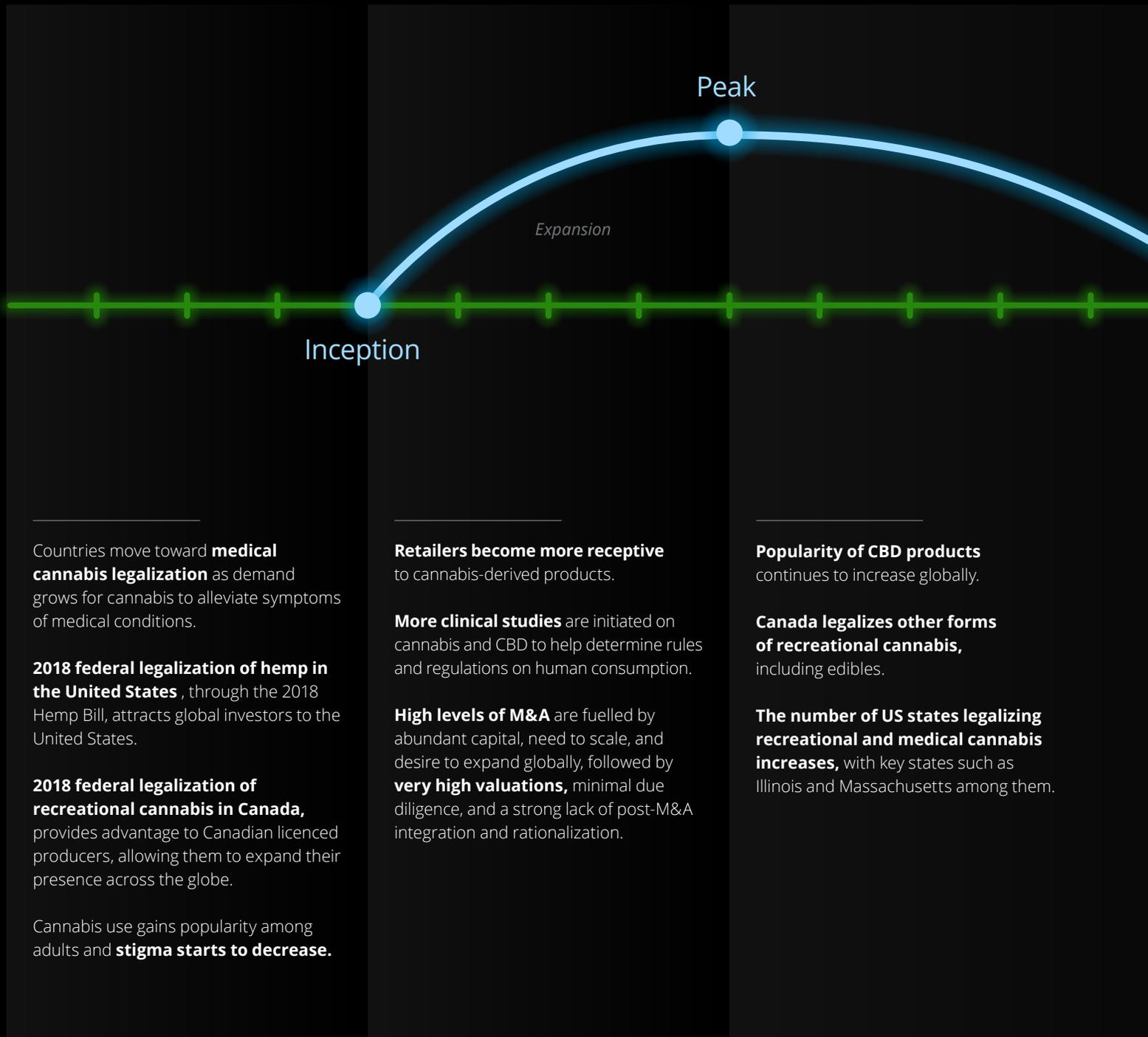
## We see the cannabis industry as going through the business cycle of a nascent industry

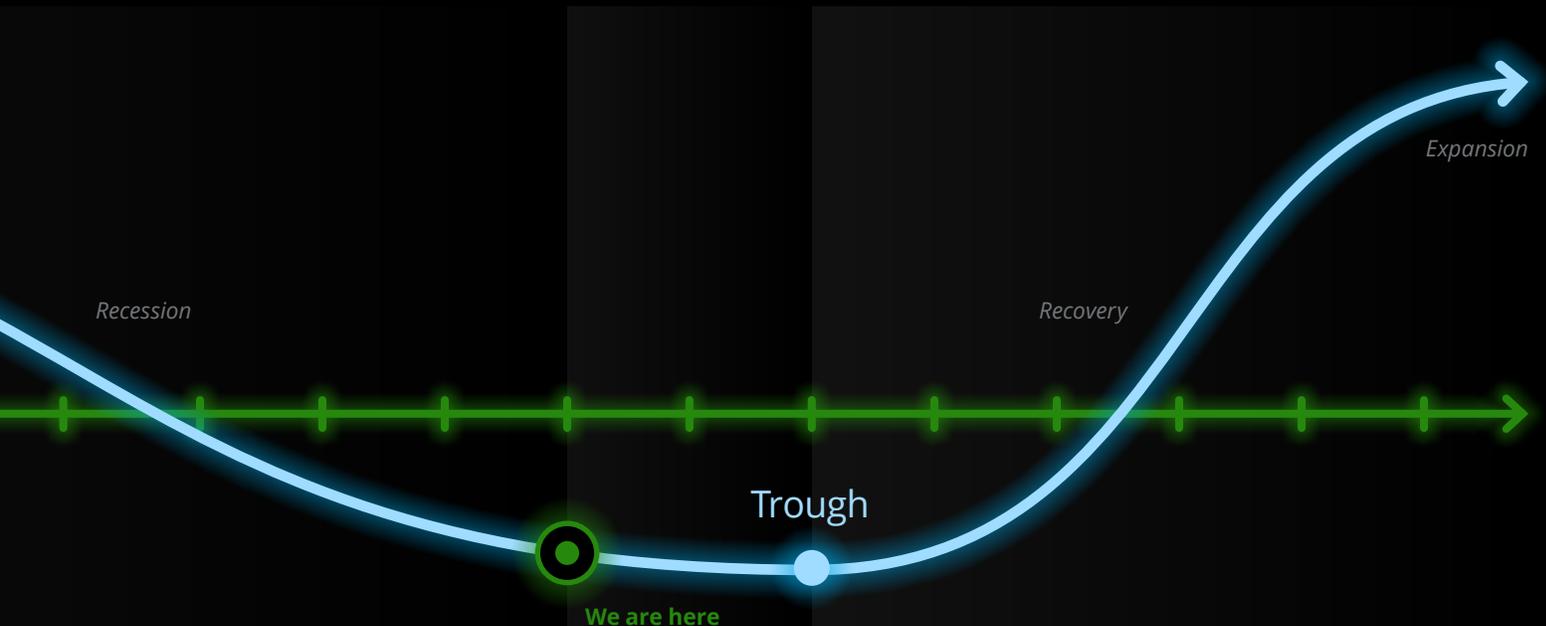
To a casual observer, the cannabis industry has been on an especially wild ride over the past couple of years—rocketing skyward only to suddenly stutter, slow, and come back to Earth.

In reality, what we've seen is a new global industry experiencing its first business cycle (see Figure 1). Legalization in select US states followed by federal legalization in Canada and federal legalization of hemp cultivation in the United States, both in 2018, fanned the flame of the nascent spark of an industry; the investor capital that then poured in provided the fuel. Canadian licensed producers rapidly expanded and moved into new markets worldwide. Other nations have also legalized cannabis to various degrees, or have taken steps toward doing so. This surge of cannabis-related activity attracted even more investor interest. Abundant capital, a need to scale, and a driving ambition for further global expansion led to an incredible amount of merger and acquisition (M&A) activity—and incredibly high valuations.

However, the industry's rapid, frantic ascent sometimes resulted in mistakes being made. Due diligence was sometimes done with less rigour. Post-merger integration planning wasn't always given much attention. A relentless focus on growth led to workforce, process, and operational inefficiencies. Regulatory environments remained incomplete, contradictory, or both. Companies began to fall short of market expectations. Some declared bankruptcy. Investors grew weary, and share prices fell. And then COVID-19 hit, sending the global economy into a sharp, swift downturn unlike anything we've seen.

Figure 1. The cannabis industry's first business cycle





**There is sporadic regulation of rules about CBD products** (e.g., EU novel food regulation guidelines).

**There are delays in establishing a legal cannabis regulatory framework** and integrating it with existing laws and regulations.

Some cannabis firms declare **bankruptcy amid lower-than-expected market performance.**

**The COVID-19 pandemic and oil crisis** induce a global economic downturn, which heavily affect the cannabis industry despite cannabis businesses being classified as essential services in many key markets.

In the recession and trough phase, expect to see a **lack of capital driving distressed company and asset sales.** **Also, as companies de-integrate,** M&A will have less of a conglomerate characteristic and be more aligned to an acquirer's core business activity.

As the industry recovers, the **remaining cannabis companies will be more specialized, professionalized, and follow prudent M&A practices,** meaning that wildly inflated valuations and non-strategic M&A become less common.

# Moving forward with confidence

Market sentiment turned on cannabis companies in the past year as investors began to question the sector’s “expansion above all” ethos and stakeholders’ trust was dented by a number of issues that came to light:



## **Neglected investment in key value chain areas**

In Canada, an excessive focus on investment and expansion of upstream cultivation and production assets led to product oversupply, requiring cannabis companies to incur significant losses and inventory write-downs. This situation has been exacerbated by a lack of investment in both distribution assets (e.g., physical retail locations, wholesale operations) and product quality (e.g., genetics, strain consistency), which has customers and other stakeholders questioning whether they can trust companies to deliver on their promises. More broadly, cannabis companies have also largely neglected investments in a key capability, analytics, particularly with respect to customer data.



## **Compliance failures**

Recently, high-profile compliance failures by cannabis companies—such as running afoul of licensing regulations by operating unlicensed cultivation operations or violating the US Food and Drug Administration’s marketing and advertising guidelines—have occurred. These failures shone a harsh light on operational deficiencies and lack of adequate controls and governance. The cannabis industry’s long-term success is dependent on governments’ trust that cannabis companies will conduct themselves ethically and abide by the laws and regulations in place. If companies lose stakeholders’ trust in this area, the financial and reputational impact could be devastating—and nearly impossible to recover from.



## **Public health concerns**

Health authorities want to ensure that the public can trust that cannabis products—medical or recreational—are safe, high quality, and effective, and hundreds of clinical studies are underway to examine the long-term public health impact of cannabis consumption. Authorities often treat medical cannabis as a “special” drug instead of an authorized, registered pharmaceutical, and no health authorities currently permit cannabis companies to make any health claim about their products unless substantiated through clinical trials. This has hindered many cannabis companies seeking to market and promote their products from a medical perspective, and the ability of cannabis companies to attract significant investment from the pharmaceutical sector.



## **Difficulty raising capital**

Amid the turmoil, cannabis companies have found it increasingly difficult to raise capital. Investors want to trust they are supporting organizations that can be trusted to deliver while operating ethically and transparently, and events over the past year have given many of them pause. While vertically integrated cannabis companies in the United States and elsewhere have started to garner interest from private capital, many companies have little choice but to raise funds through debt, and we’ve seen an increase in debt-raising among Canadian cannabis companies.



## **Insolvencies driving distressed asset and company sales**

With difficulty raising capital and a deterioration of initial and earlier funding, the industry is likely to experience a wave of distressed asset and fire sales. As of August 2020, there have been seven notable bankruptcies.

These issues are among the reasons why cannabis share prices fell by over 80 percent between early 2019 and September 2020 (see Figure 2) and remain highly volatile today.

**Trust plays an important role as well.**

Deloitte research has shown that companies will experience the financial and reputational impact of adverse trust-related events soon after the revelation of misconduct or questionable behaviour—and even a speedy response may not be enough to persuade stakeholders that a company is trustworthy.

Now, it appears that the excitement and bullishness that characterized the cannabis sector have given way to skepticism, prudence, and sober reassessment. The cannabis industry is getting ready to grow up, like the breakout industries before it.

Addressing past mistakes and questionable actions will be critical to regaining the market’s trust in the industry overall. And taking concerted, active steps to foster trust will be critical if cannabis companies are going to grow, thrive, and win in the years to come. Their leaders will need to determine what their stakeholders expect of trustworthy organizations and then take steps to deliver on those expectations. Those that successfully build, rebuild, and continue to earn stakeholders’ trust will be better able to stay resilient in challenging times—and stand apart in a crowded, ever-shifting business environment.

**Figure 2. Decline in TSX/S&P cannabis index pricing, 2019-20**

Source: S&P Capital IQ; data to June 30, 2020

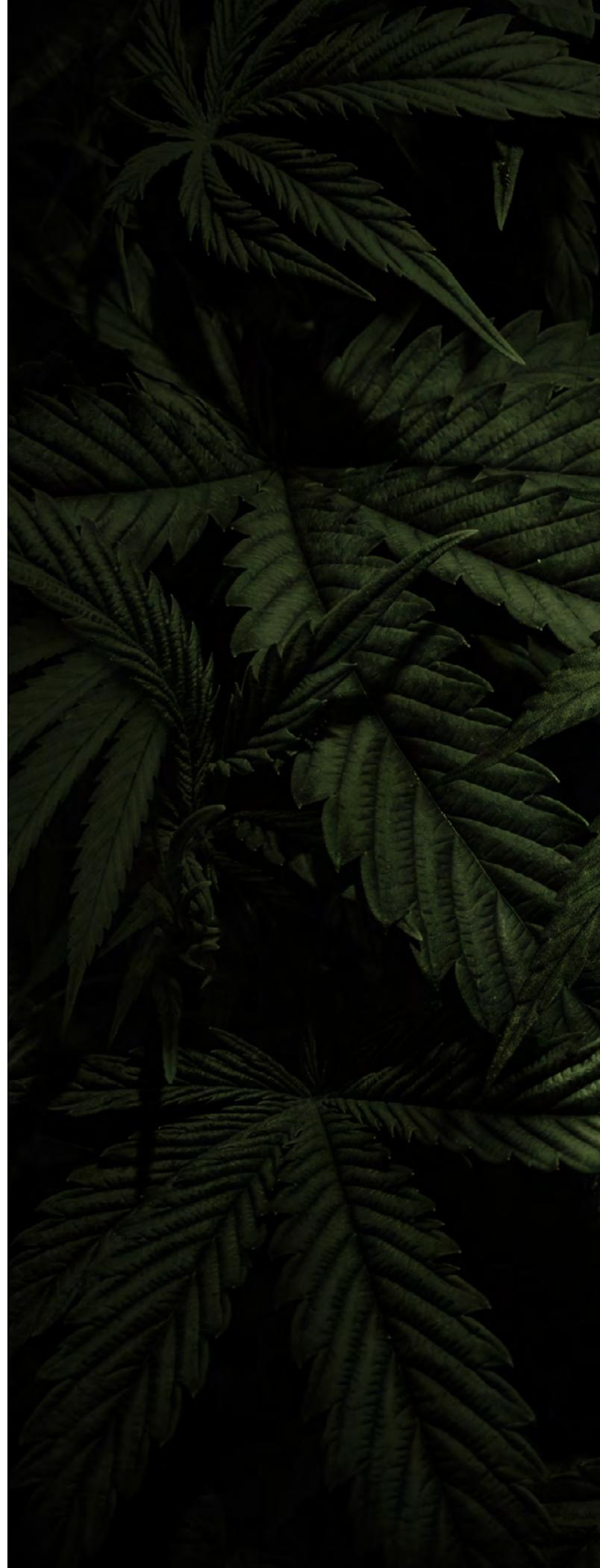


# Develop a strategic focus

One of the more notable aspects of the early days of the industry is the lack of specialization—or, put more bluntly, strategic focus. Most cannabis companies entered the market with broad ambitions. They targeted recreational and medical cannabis consumers, as well as those more interested in cannabis health and wellness products. They produced combustibles, but were also eager to get involved in edibles, oils, and other alternative products. And they were found in all parts of the value chain, from cultivation and processing to distribution and retail.

The result? Trying to be all things to all people—a costly, highly inefficient approach to doing business. Moreover, after two years of legalized recreational cannabis in Canada, no clear leaders have emerged in any high-potential segments such as CBD.

For the industry to regain its footing and get back on the path to sustainable, long-term growth and success, cannabis companies must get more sophisticated about their business and develop a strategic focus. They must narrow and choose who their customers are, what products they'll sell, and what value chain niche they'll fill. Those opting for focus and depth will emerge as industry leaders.





Cannabis companies must get more sophisticated about their business and develop a strategic focus.

# Choose a market: Where do you want to play?

Emerging product types and formats are fuelling participation and innovation in the industry. However, despite the demonstrated interest, no leadership has been established in many high-potential market segments, such as the CBD segment. As the industry becomes more sophisticated, companies with focus and depth will take the lead.

It has taken time for the cannabis market to grow to a point where companies in the sector can realistically contemplate focusing on particular product types or formats. Taking a do-it-all approach may not have been the most efficient way to do business, but cannabis companies needed time to discern and understand not only their strengths and weaknesses, but consumers' product preferences and purchasing behaviours. They also needed more certainty on the regulatory front to be able to pursue edibles and other cannabis products.

Now, as the industry heads toward its eventual recovery without what seemed like unlimited capital investment, cannabis companies are forced to focus their limited resources on those product categories that offer the best growth potential.



## Recreational cannabis

From combustibles to edibles and beverages, the recreational market is geared toward casual and occasional consumption, either in social settings or for personal enjoyment. Intoxication—the buzz factor—is the key draw, so THC-based and mixed THC/CBD products are the focus. This segment has the most in common with other regulated products aimed at adult consumers, such as alcohol and tobacco, and many countries may have similar restrictions on product sales and marketing.



## Medical cannabis

The medical cannabis industry is highly regulated by government bodies and usually requires companies to go through a lengthy process to be able to launch and market products. Only a handful of clinically proven medical cannabis products are currently available on the market, and they are typically offered in the form of oral solution (oil, tincture, spray) or capsules. These cannabis medications have clinical evidence for their alleviation of symptoms for illnesses and medical procedures such as epilepsy, multiple sclerosis, chronic pain, depression, and chemotherapy. Many countries permit doctors to prescribe medical cannabis, but patient access to these medications may be limited due to bureaucratic procedures, supply shortages and strict eligibility criteria. The role of the government is critical in effectively providing an adequate level of access to those who are eligible. There is another layer of complexity for some countries that have differing state laws.



## Health and wellness

CBD and hybrid products, including topicals, oils, capsules, and cosmetics, dominate this product category. Unlike THC, CBD is not a psychoactive substance, and this has helped CBD and hybrid products become immensely popular despite the regulatory uncertainties that still surround them. Products in this category are typically marketed as health supplements or for self-care uses; while companies are often forbidden to make health-related claims for these products, consumers cite their usefulness in treating pain, inflammation, sleep issues, and more.

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As the industry recovers, cannabis companies should consider the product segment that best fits with their vision and goals for the future and then pivot the organization to focus all its time, energy, and resources on it. In time, as the sector continues to mature and the regulatory picture grows clearer, we should expect major players from outside the sector to exert more influence in the space. Alcohol and tobacco companies, accustomed to operating in a regulated environment, are already active in this sector; most other disruptive entrants, such as those in consumer goods, are taking a much more cautious approach. No matter the nature of their move into the cannabis space, these new entrants will bring their experience, scale, and vast resources to bear on the sector, and the impact will be transformational.

# Identify your customer base

Any market entry strategy should be accompanied by an in-depth understanding of the consumer base in the new market. It's critical that your business strategies align with key insights from your existing and target customer base.

Any go-to-market strategy must be rooted in an in-depth understanding of the customer base. It's crucial that cannabis companies align their business strategy to key insights into existing and targeted customers.

The first step is to build a basic customer segmentation framework. Customer segments in this framework might include current consumers; consumers who are interested in cannabis but haven't yet tried it; caregivers and others who purchase cannabis products for medical use; and non-consumers currently uninterested in trying cannabis.

Once this framework is in place, companies should map customer data to it. Key elements for mapping include the customers' reasons for consumption (e.g., social, medical conditions, sleep issues) as well as their purchasing considerations (e.g., brand familiarity, product format, price, insurance coverage, manufacturer reputation). These elements will play a pivotal role in shaping a company's approach to branding and marketing—within regulatory limitations, of course.

Companies can take additional steps to deepen their understanding of their customers and test business hypotheses. Leveraging external data sources can sharpen insights into key customer segments. Sending tailored communications to each segment can deepen customer engagement and lead to more learnings. Customer surveys can help organizations detect product and market trends, and changes to consumer behaviours and preferences.

# Focus on your key competencies

The value chain for cannabis products can be separated into primary components related directly to production and ancillary components for products and services supporting the primary value chain. While in some jurisdictions companies are required to be vertically integrated, companies that focus on their key competencies will likely lead the industry.

The cannabis value chain can generally be divided into two main streams. The primary value chain involves activities directly related to producing and selling cannabis and cannabis products: cultivation, processing and extraction, production and packaging, and distribution and retail. The secondary value chain involves important ancillary activities related to the sector: research and development, regulation and compliance, professional services, testing, and the manufacture and sale of technology, equipment, and other supplies.

Some jurisdictions require cannabis companies to be vertically integrated and responsible for each part of their value chain. Outside of those jurisdictions, companies should consider pursuing a strategic realignment of their business that focuses on key competencies and those parts of the supply chain that offer the greatest opportunity for competitive differentiation, scale, and growth.

Companies that focus their attention on their strengths and key competencies will be better positioned to achieve industry leadership in their part of the cannabis value chain. As companies focus on certain segments and exit others, the industry will benefit overall. Specialization will enable cannabis companies to achieve scale and deploy capital and other resources more efficiently.

## Focusing on your key competencies: Important considerations



### Cultivation

- Existing indoor/outdoor cultivation infrastructure
- Cultivation licensing regimes
- Restrictions on cannabis/hemp cultivation
- THC limits for cannabis/hemp



### Processing and extraction

- Cannabinoid extraction processing capacity
- Restrictions on processing of cannabis plants
- Ability to import/export biomass
- Availability of brokers to connect cultivators with extractors



### Production and packaging

- Range of allowable products
- Cannabinoid content restrictions for specific products
- Packaging requirements
- Marketing, branding, and advertising restrictions



### Distribution and sales channels

- Restrictions on sales channels for THC and CBD products
- Mix of physical/online retail presence
- Extent of government involvement in retail
- Restrictions on physical retail presence (e.g., licensing limitations)



# Rightsize the right way—and professionalize in key areas

Many cannabis companies have responded to the industry's recent challenges by cutting costs, reducing workforces, optimizing operations, and more in an effort to better reflect current market realities.

This rightsizing impulse is understandable, but there are risks. Overly broad or indiscriminate rightsizing efforts can be counterproductive, if they hinder companies' efforts to position themselves for success. Instead, every company should ensure any activities to trim costs support the overall business strategy and vision for the future.



## Identify the key rightsizing actions

A gap analysis can help cannabis companies determine which rightsizing actions will best support their organization's strategic vision. Comparing the company's current state to its desired future state can help leaders identify the capabilities required and the strategic decisions management needs to make to close the gaps and target the most appropriate rightsizing actions. And these actions may not automatically involve cuts, either; in some cases, rightsizing may involve new investment.

For example, a company's gap analysis might uncover a need to develop better analytics capabilities in order to obtain deeper customer insights; in this case, recruiting talent with data analytics skills and knowledge is an appropriate rightsizing action. The analysis could point to a need to focus on a specific geographic region, which would drive exits from regions outside that area of focus and cuts to related corporate overhead. One cannabis company might identify a need to get out of unprofitable ancillary activities in the secondary value chain, leading to the sale or closure of various products, business lines, or functions.

Another company could find itself in need of improved research and development (R&D) capabilities or access to new intellectual property (IP) in order to drive new product development; this could lead to a need to invest in internal R&D, better screening of acquisition targets, or both.

Regardless of the nature of the rightsizing activities identified by leadership as the result of their gap analysis and other planning, it's vital that cannabis companies establish key performance indicators (KPIs) for each activity.



## Bring in the professionals

The first years of the cannabis sector were driven by vast amounts of entrepreneurial energy—by leaders and investors with a willingness to take significant risks to bring an entirely new industry to life. As an industry matures and companies grow, however, the nature of doing business gets increasingly complicated: financial reporting requirements increase, tax and legal issues grow more complex, and even the day-to-day management of the organization becomes more challenging. In addition, cannabis companies must navigate an ever-changing web of regulatory compliance matters.

Addressing these increasing challenges and responsibilities requires more than entrepreneurial buccaneering: it takes experienced professionals with subject matter expertise and an understanding of what it means to operate a sizeable private or publicly traded company under significant regulatory scrutiny. Industry professionalization began, with major cannabis companies starting with changes in the executive suite.

Professionalization is a critical factor in strengthening the cannabis industry's foundation and supporting its continued evolution and growth. It's especially important in helping companies smooth regulatory pathways and establish consistent, standardized processes and procedures, though they can benefit from professionalization across their organization.

In our view, some of the key functions and responsibilities that are candidates for professionalization include:

#### **Quality frameworks and standards**

Cannabis products are subject to a myriad of quality frameworks and standards as well as authorization requirements. These may apply in one jurisdiction, or several. The Good Production Practice framework, for example, applies in Canada alone, while the Good Manufacturing Practice and Pharmaceutical Inspection Cooperation Scheme are multi-jurisdictional. Regulatory frameworks may also incorporate elements of frameworks originally developed for other types of products: Canada's cannabis regulations, for example, incorporate elements of the Safe Food for Canadians regulations, cosmetics regulations, and the Tobacco and Vaping Products Act.

#### **Financial reporting**

Cannabis companies must meet the applicable financial reporting requirements in each jurisdiction they operate in, and expansion into new jurisdictions only adds to the complexity. The very nature of expansion can impact financial reporting requirements as well. A cannabis company could expand internationally by, for example, buying existing local facilities, building new facilities, acquiring a similar local business, or launching a joint venture. For each strategy, the accounting treatment must be carefully considered. In addition, internal control over financial reporting is always critical, but it becomes much more complex if a company's operations span borders. CEO and CFO certification requirements extend across a company's global operations, and internal control processes abroad may not be as rigorous as those of the parent company. As well, companies may find it difficult to recruit qualified finance talent in jurisdictions where cannabis legalization is a newer phenomenon.

#### **Licensing**

A jurisdiction's legal framework influences the cannabis products that can be made available on the market. Only Canada and Uruguay currently have legal frameworks for both medical and recreational cannabis products; others, such as the United Kingdom, Denmark, and Germany, have legalized medical cannabis nationally. In the United States, a number of individual states have legalized recreational and/or medical cannabis without federal approval. Most jurisdictions categorize and issue licences based on activity, including cultivation, manufacturing, sales, distribution, and importing/exporting. Some, such as Germany, permit vertical integration. Some have limited the number of licences available, or imposed limits on production or space. There are jurisdictions that have adopted a phased approach to licensing based on companies satisfying certain criteria at particular milestones. And some run pilots with small-scale medical cannabis programs with domestic cannabis cultivation.

#### **International trade**

Global trade in cannabis and hemp is governed by three United Nations drug control treaties and international trade and investment law; these guide UN member states' import/export measures and domestic drug control laws and policies. The import or export of cannabis/hemp-derived products depends on a host of factors: the legal status and classification of cannabis, as well as allowable product formats, in the countries of origin and destination; applicable licensing for import, export, manufacture, processing, possession, distribution, and sale; meeting relevant quality and manufacturing standards in the countries of origin and destination; origin of genetics; intended use, and applicable trade laws with respect to import and export. As international trade in medical cannabis, as well as non-medical products derived from hemp or cannabis, continues to develop, it's imperative that cannabis companies have the capability to stay up to date.

### Tax and legal

Cannabis companies must navigate a complex web of tax and legal requirements, including those specific to the industry. Those operating internationally must also ensure their compliance with tax and remittance requirements in domestic and foreign jurisdictions, from income tax and value-added tax (VAT) to employer taxes, stamp duties, trade taxes, real property taxes, and payments to non-residents for such things as interest and dividends, royalties, and technical services. Cannabis companies considering international expansion must also contend with additional considerations. These include matters relating to setting up a foreign operation, including: corporation type, board structure, and local incentives; issues related to ownership and development of intellectual property and other intangible assets; and inter-company services, from standard operating procedures to licence-application processes.

### Marketing and advertising

The information that can be displayed in marketing and advertising materials, including packaging, varies by jurisdiction. For example, in Canada, packaging features that can be deemed as appealing to children have resulted in restrictions on product names, logos, colours, fonts and types of packaging finishes. Disclosure of specific product information is often required, such as the potency or percentage of cannabinoids and nutritional facts, in the case of edibles or beverages. Health warnings, similar to those on tobacco products, may also be mandatory. Making health claims is also restricted: any such claim must be supported by evidence from clinical trials and scientific literature.

### Packaging and labelling

Given that compliance varies by product type and jurisdiction, packaging and labelling considerations can be complex. Packaging varies depending on the format of the cannabis it is designed to contain, the intended use, and the class of product:

**Dried flowers:** Packaging can come in the form of glass jars, mylar bags with tamper-proof, child-resistant, resealable closures, or tin cans.

**Concentrates:** Usually found in small glass containers with child-resistant caps. Can include droppers, vape cartridge blister packaging.

**Topicals:** Popular formats for creams, balms, and salves include plastic or glass containers that are child-resistant; secondary packaging is often paperboard box.

**Edibles:** Due to the breadth of this category, a variety of package formats is used; convenience and environmental concerns may influence choice.

Additionally, there are specific packaging requirements for different parts of a package (e.g., the inner container, the outer wrapper) and size restrictions based on possession and dispensing regulations. Furthermore, there is format-specific legislation as well as package licence requirements, which can be governed by different levels of government—Canada and Germany at the national level, for example, and at the state level in the United States.

# What goes around comes around

If the cannabis industry's rapid rise and equally fast comedown seems strangely familiar, that's because we've seen this trajectory before. The cannabis sector's current business cycle strongly echoes that experienced by other nascent industries, particularly the internet technology sector that arose in the late 1990s (see Figure 3).

Excitement, hype, lots of investment, sky-high valuations—the internet tech sector had it all. Then the dot-com bubble burst in 2000 and share prices fell through the floor, followed by 9/11 and the Enron and WorldCom scandals. Share values didn't recover until 2015.

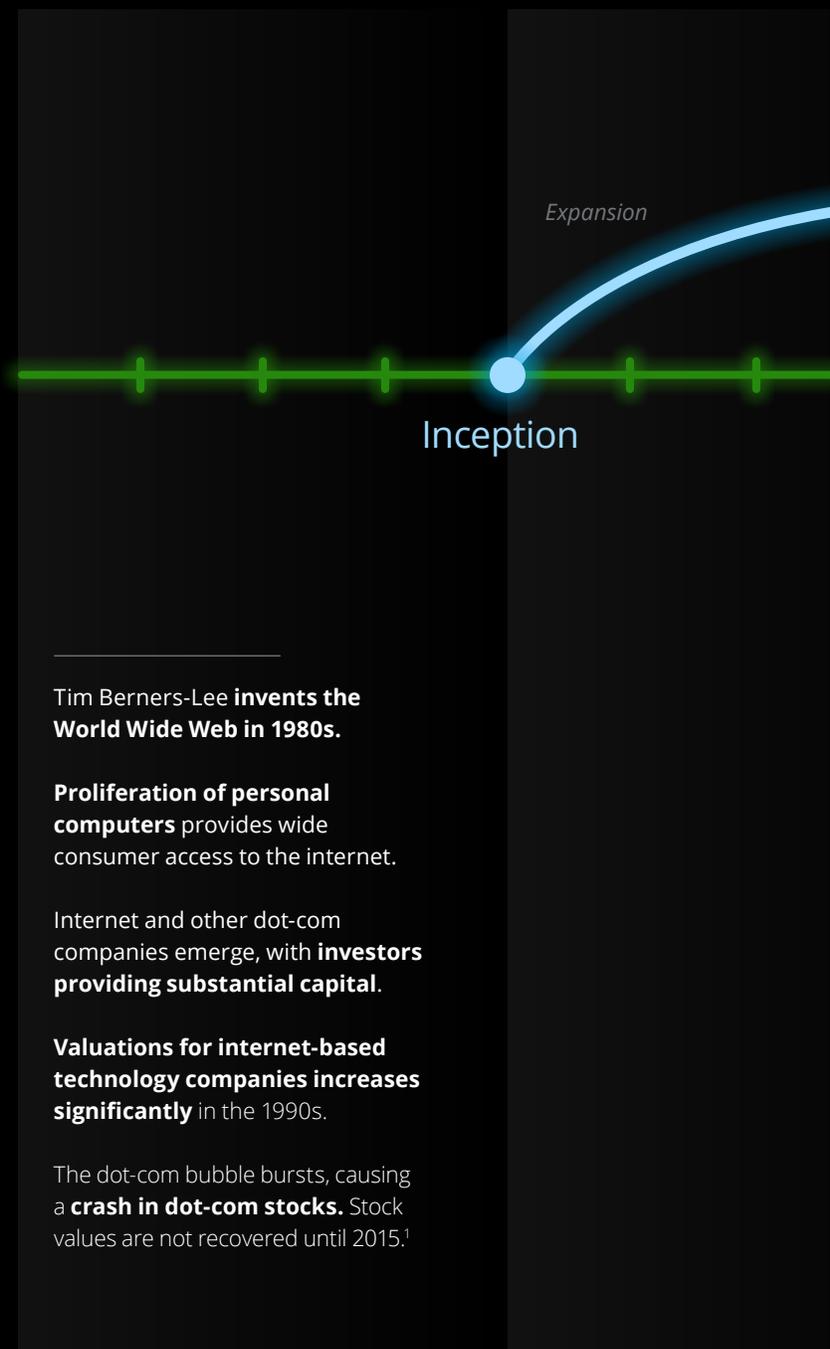
The so-called dot-com companies responded by embracing the need for change—reassessing the situation, developing a strategic focus, and rightsizing accordingly. As a result, market leaders emerged in various technology areas, the industry stabilized, companies consolidated, and growth and expansion resumed.

**Recovery from the burst of the dot-com bubble was accelerated by companies such as IBM, which established industry leadership by introducing industry standards and best practices, specialization, and demonstrating innovation.**

**Such leadership has not yet been established in various areas of the cannabis industry. Without a group of leading bodies to facilitate and guide the industry in a direction where a stronger global foundation can be built, growth will be limited.**

**Figure 3. Dot-com industry business cycle, 1980s–present**

Source: <sup>1</sup>Investopedia





Events such as the **September 11 attack**, and the **Enron and WorldCom scandals** accelerate the **stock market drop of the early 2000s**, similar to how the existing problems in the cannabis industry (e.g., profitability issues, management turnover) are amplified by COVID-19.

With only limited capital available, **the operating mentality of executives and management changes**, to a focus on cost reduction and rightsizing.

Eventual expansion was facilitated by the **infrastructure and economic foundation built during the initial expansion** and peak phase.

Growth in the technology industry **stabilized over time** and the companies consolidated.

Google rose in the search engine market.

**Market leadership was established** in specific areas of the technology field (specialization).

The technology industry is dominated and **led by companies that survived the dot-com crash**, including IBM, Oracle, eBay, etc.

# Prepare to expand

The cannabis industry is in a period of retrenchment, weathering not only the normal ebb of the business cycle but also the COVID-19-driven economic downturn. In time—and after deliberate efforts to better understand the state of the cannabis market, refocus on new strategic priorities, to rightsize and to professionalize—cannabis companies will be in a stronger position to pursue growth and expansion once more.

They should focus on using organic and inorganic expansion opportunities that further their strategic ambitions—solidifying their position in an area of the value chain, for example, or expanding into a new market, product, or consumer segment. If well planned and well executed, these expansion investments will support companies in their efforts to become leaders and thrive in the markets they choose to play in.

Trust will play an important role in the success of cannabis companies' expansion efforts. Companies that have earned and retained the trust of investors, regulators, and other stakeholders are likely to be well regulated by potential partners and regulatory authorities in other markets. Honest parties that act with integrity and conduct themselves ethically and responsibly may find doors opened more readily—and deals approved more quickly.



## M&A activity likely to heat up in the near term

It's very likely that the near term may see significant, strategic M&A across the cannabis sector. Large companies are selling assets during the downturn in order to improve profitability and meet investor expectations. Bankruptcies and distressed-asset sales will also contribute to a higher level of M&A activity, providing an opportunity for larger cannabis companies to increase scale, smaller cannabis companies to establish a foothold, and disruptive players to enter the market. We should also see a wave of consolidation and acquisition activity involving small and mid-sized cannabis companies as larger players capitalize on distressed company valuations.

We also anticipate that the cannabis sector will see a rising number of global partnerships and alliances. This development should both accelerate the pace of innovation and help companies differentiate themselves in a crowded market.

Finally, now that the cannabis industry has established itself and has begun to tackle its growing pains, we expect to see strategic M&A activity and new, disruptive market entrants—particularly from the food and beverage, consumer packaged goods, and pharmaceutical industries—as cannabis-related regulatory uncertainties are resolved and the risks of entering the cannabis market abate. This will have a significant impact across the industry and around the globe.

# A framework for expansion

Cannabis companies should consider a number of key criteria in evaluating and prioritizing their expansion opportunities. These include:



## Strategic fit

How well does the opportunity correspond with the company's overall business objectives?

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## Size of opportunity

What is the impact of the opportunity on revenue or market share?

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## Risk/due diligence

What are the risks involved in pursuing the opportunity? What is its potential impact on the company's finances, operations, and overall integrity?

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## Research and development/ intellectual property

How will the opportunity help the company gain a competitive edge in terms of its R&D efforts and intellectual property?

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## Competitiveness

How will the opportunity strengthen the company's competitive advantage in the market?

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## Leadership support

How well will the opportunity help the company seize a first-mover advantage and establish or build market leadership?

# Expansion: Six markets to consider



Where should cannabis companies focus their expansion plans? We've identified a half-dozen markets based on our assessment of a number of factors, including regulatory environment, ease of doing business, and level of domestic investment in cannabis.



## Canada

Canada is, of course, one of the few countries in the world that has legalized recreational cannabis, including edibles, nationally. The federal Cannabis Act governs all cannabis products in the country, regardless of their source, while each province or territory sets its own rules and regulations regarding retail.



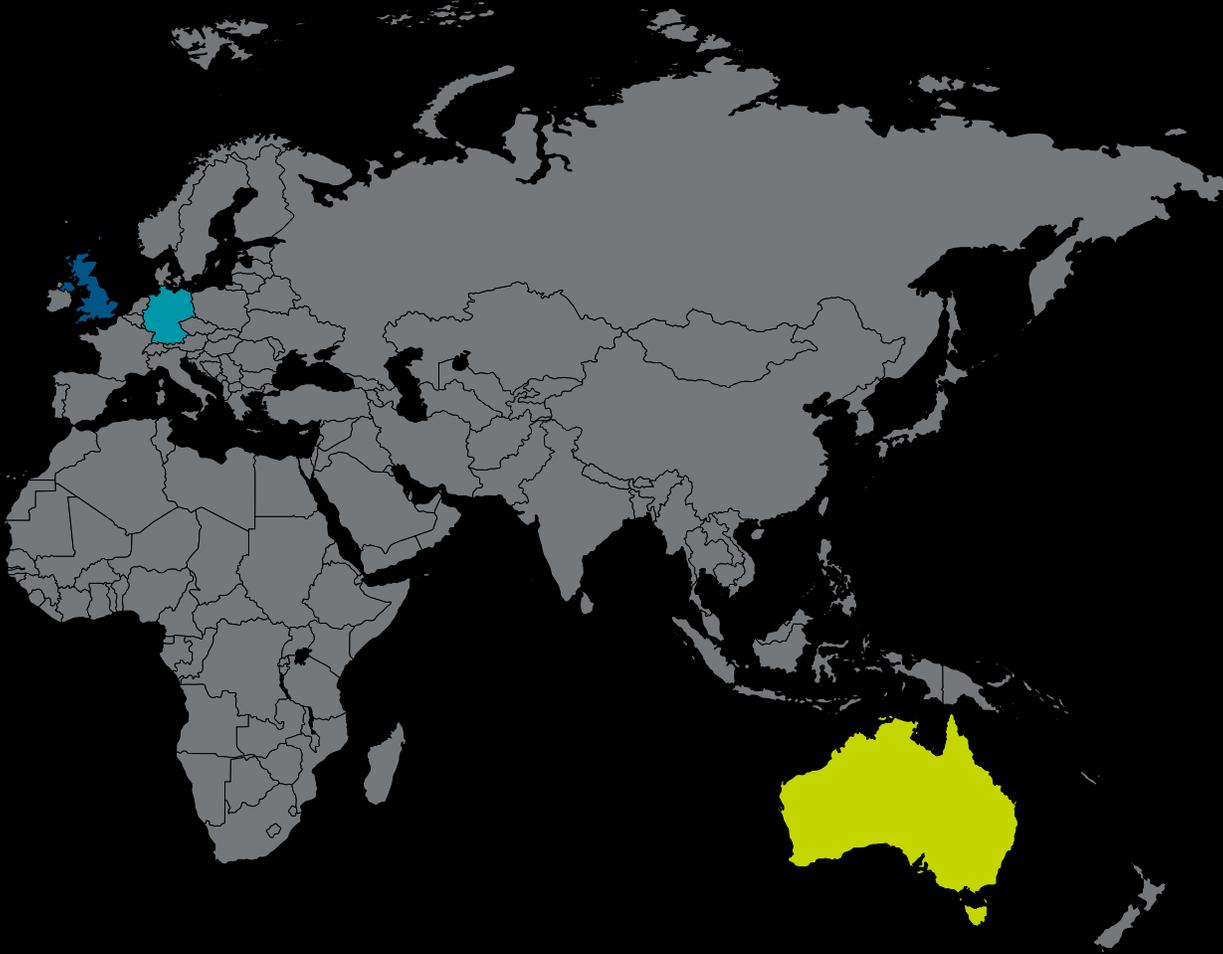
## United States

The US cannabis market remains highly fragmented; while legal in many states, it remains illegal at a federal level. National legalization remains uncertain. Companies therefore must view the US market on a state-by-state basis given the varying state-level regulations. One of the most important areas to be looked at when entering the US market is the matter of federal legality risk and its impact on interstate commerce.



## Latin America

Latin America and South America have the potential to be major cannabis markets, having both a deep consumer base and a developing infrastructure for production. Brazil has one of the world's largest markets for medical cannabis. Mexico is on a path toward full legalization and commercialization, while Colombia has established itself as a cultivation and export market.



## United Kingdom

While only medical cannabis is currently legal in the United Kingdom, the country is home to one of Europe's largest markets for CBD products. However, the UK Food Standards Agency has expressed its alignment with the EU's classification of CBD as a "novel food"; as a result, all CBD products must now be submitted to the FSA for novel food authorization in order for the products to remain on shelves. Additionally, it is not known what impact Brexit will have on the UK cannabis industry.



## Germany

Only medical cannabis is currently legal in Germany, and the country is heavily reliant on imports from Canada and other countries. Like the United Kingdom, Germany classifies CBD food and beverage products as novel food.



## Australia

Cannabis rules and regulations vary from state to state, adding complexity for companies. While the Australian Capital Territory recently legalized its recreational cannabis use, only medical cannabis is allowed in other states. However, rigid processes make it challenging for patients to access medical cannabis products.

# The industry's future is bright— but all players must work together to make it a reality

We are optimistic about the future of the global cannabis industry. Its recent ebb has not diminished its impressive potential for ongoing expansion and resurgent growth. Other countries and jurisdictions are poised to follow in Canada's legalization footsteps, creating new opportunities. And we can take comfort from a strong parallel between today's cannabis sector and the experiences of the technology sector, which overcame its early challenges to become the thriving global industry we know today.

However, to achieve its potential, every industry player—companies, governments, and regulators alike—must collaborate at a global scale to shore up its foundations. Global standards for products need to be developed. A clear regulatory pathway for cannabis- and hemp-derived products needs to be established. A strong foundation for international trade must be built. And the industry must transform to become much more customer-centric than it has been to date.

Individual companies must also take action. The first step is to reflect on the state of the industry and the lessons learned from the sector's swift, remarkable rise and its recent return to Earth. Then it is time to move forward in several ways, by:

- Developing and refining a strategic focus that enables them to target the right customers with the right products and play to their strengths in the cannabis value chain.
- Rightsizing the workforce and operations in a way that supports this fresh strategic purpose—and recruiting professionals with the experience and knowledge required to deliver a new level of performance, consistency, and compliance.
- Scouting promising new markets and preparing for expansion when the time is right.

The cannabis sector has what it takes to fulfill its enormous potential. Now it's time for leaders, governments, and regulators around the world to work together to ensure the industry makes the vital changes needed to set itself up to thrive in the years to come.

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