

FROM THE BLACK MARKET TO THE CORNER MARKET

What's happening in the projected \$50 billion cannabis retail market

by CRAIG GUILLOT

As more states move toward legalization, marijuana is quickly becoming a legitimate and viable industry. From the farms and labs to the countertops and backrooms of dispensaries, the retail industry is in the midst of a rare transition where a lucrative black-market product goes legal and mainstream.

Many industry experts say that within a decade, the federal government will remove marijuana from the list of controlled substances, at which point they believe there would be exponential growth within a few years.

The cannabis retail market is already thriving in the states where it is legal, and thousands of dispensaries are moving billions of dollars worth of the product every year. While the basic retail principles may be the same, their products are anything but ordinary and come with red tape, big risks and operational challenges. Until big national players move in, the industry is largely being driven by ambitious, risk-taking entrepreneurs and private investors.

Medical marijuana use is currently legal in 29 states, and recreational use is now legal in Alaska, Colorado, Maine, Massachusetts, Nevada,

Oregon, Washington and the District of Columbia. When California officially legalizes recreational “adult use” sales in January 2018, the state will become the largest legal market in the world: A study by the University of California Agricultural Issues Center forecasts more than \$5 billion in sales in the state in the first year, and a recent report from Marijuana Business Daily estimates the national market will grow to nearly \$17 billion by 2021.

Support for legalization is also at an all-time high, and a 2016 survey from Gallup revealed that 13 percent of U.S. adults said they used it, up from only 7 percent in 2013. The retail cannabis industry is already well-established; according to Marijuana Business Daily, the average dispensary produces an annual revenue of \$974 per square foot.



LivWell Enlightened Health is one of Colorado's fastest-growing cannabis chains with 14 medical and recreational store locations. Dianne Brown, LivWell's senior director of sales, says the company operates like any other retailer, aside from compliance issues. LivWell carries a wide array of products, markets the items and brand online and aims to serve with superior customer service.

"Just like any other retail business, success is based on understanding your customer," Brown says. "Who they are, what their needs and pain points are and how to design the store to create a comfortable and easily navigable shopping experience."

The market is comprised of far more than "smokeable" product: While raw "flower" remains the most popular segment, there are also concentrates such as wax and edibles that can include everything from baked goods and gummies to pills and tinctures. Brown says another growing category is topicals, which include lotions, creams, bath products and patches. And even within the products themselves, there are hundreds of strains with varying levels of active ingredients that can produce varying effects.

THE NEW CONSUMER

The stereotype of cannabis users may trigger images of hippies or slackers, but surveys indicate they span a range of socioeconomic classes. A study in the *Journal of Drug Issues* revealed the proportion of marijuana users who smoke daily has rapidly grown, and Gallup's research found

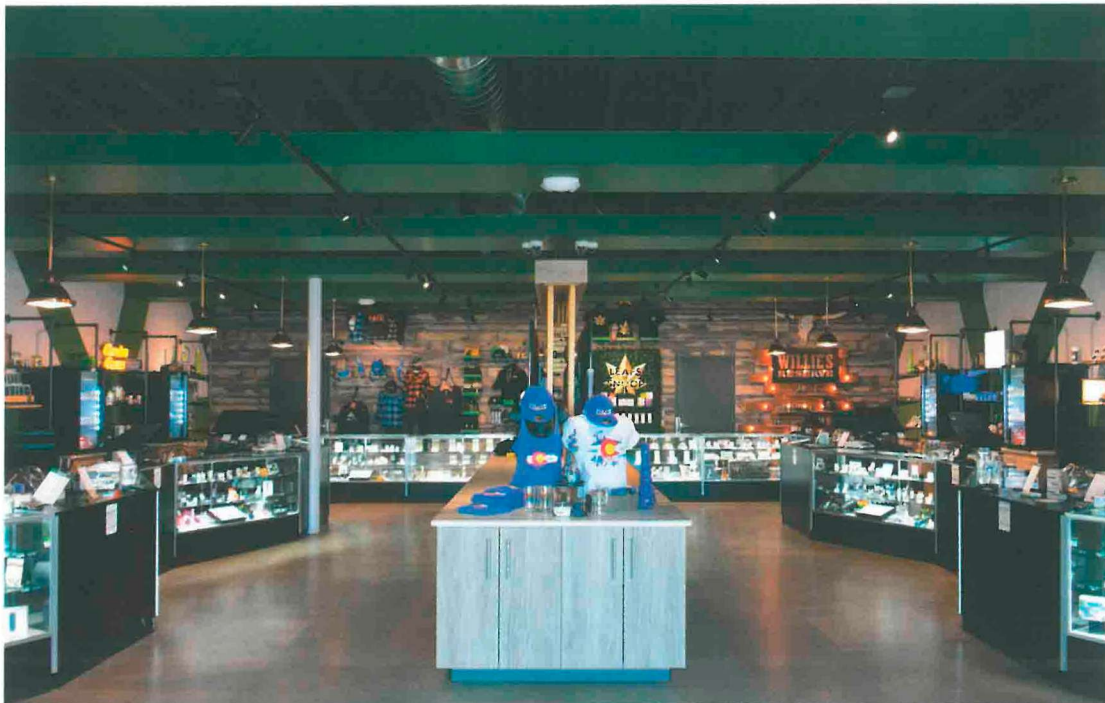
usage doesn't necessarily correlate to income or education.

The industry uses the term "cannabis" instead of marijuana, and branding often focuses on medicinal or positive benefits rather than the idea of getting high. Jeffrey Zucker, president of cannabis investment company Green Lion Partners, says most consumers don't fall into the category of "stereotypical stoners," and legal cannabis is often seen more as a health and wellness product.

Many dispensaries almost look like pharmacies. LivWell stocks a variety of pipes, topicals, edibles and flowers in glass cases. Digital screens advertise specials and new offerings, while the retailer's website lists strains with cannabinoid breakdowns and customer reviews. LivWell even has a rewards program.

"We work with experts from numerous industries to help us design our stores so that they ensure proper customer flow while creating an inviting, comfortable atmosphere for patients and customers from all walks of life," Brown says.

Because of its new legal status, dispensaries are attracting new consumers. Lincoln Fish, CEO of startup incubator OutCo, says curiosity will drive the next wave of consumers to seek cannabis as an alternative to alcohol or some pharmaceuticals. He believes use will triple in the next five years as legalization removes the threat of penalty and offers an opportunity to buy quality products, and says the ability to buy product in a licensed store rather than from a black market dealer will open new doors for many.



“They want products that are tested to know where it came from and how it was produced,” Fish says. “There are a lot of people staying out of the market because it’s illegal and they can’t know where it’s coming from.”

Cannabis retailers say a big part of the retail process is educating consumers about their products, the different strains and how it can impact users. LivWell stocks at least eight different strains across three tiers of cannabis flower offerings, as well as products from leading industry brands. The dispensary chain currently has more than 600 full-time employees; Brown says every employee undergoes two weeks of training at LivWell University where they learn everything to excel in their jobs, from how to complete a compliant transaction to the science of the endocannabinoid system.

A HIGHLY REGULATED MARKET

In most legal states, cannabis products are highly regulated from seed to sale in how they are manufactured, distributed and sold. Retailers must check identification to confirm anyone who enters their store is age 21 or older. They must also ensure all products are in the state-mandated inventory tracking system, maintain updated security plans and follow strict protocols on expired products.

“The ever-increasing cost of compliance adds further pressure to business operations,” Brown says. “Regulations are changing almost daily at the state and local level.”

While some dispensaries acquire cannabis from farms, others grow their own — Brown says plants take six months to grow from clone to harvest, on average. OutCo cultivates its own cannabis, performs research and development with scientists, manufactures infused products and sells and distributes at its own dispensary. Fish, who previously owned a nutritional supplement company and spent years selling to stores, founded OutCo in 2015 and has since grown it to be one of the largest licensed producers of medical cannabis in the southern part of Colorado.

Fish has high hopes for the industry and believes “sizeable players” will move in soon, should federal regulators loosen the reins. When that happens, he says these companies won’t start from scratch but will instead acquire the pioneers in the industry.

Rachel Weingarten of marketing and consulting firm Cannabuzz NYC says manufacturers and retailers will need to cultivate their brands much in the manner that artisan food makers do. She believes large national players and local growers and retailers can coexist in the marketplace.

Similar to the food industry, some consumers will seek out quality and premium locally sourced products while others will seek out low-cost, mass-produced options. “Sure, you’re going to have big business and you’re going to have people who make it easy and cheap,” Weingarten says. “But you’re also always going to have a demand for that local and craft market.”



such as Washington and Oregon, products must be cultivated and manufactured in the state in which they're sold.

Cannabis retailers also face the same challenges that many ordinary retailers do. There's a growing demand for point-of-sale and inventory management systems to meet the unique needs of the industry. Zucker says many companies are "winging it" with off-the-shelf solutions that don't serve their industry — some

CHALLENGES REMAIN

The biggest challenge the industry faces is that marijuana remains a Schedule 1 drug under the federal Controlled Substances Act and is illegal under federal law. That is the same category as heroin, cocaine and LSD, meaning it has a high potential for abuse and no legally accepted medical use treatment under federal law. Removal from Schedule 1 is the only path to nationwide legalization.

Federal authorities may be abstaining from enforcement, but the classification leads to a number of pain points for the industry — including limited access to traditional banking, as most FDIC-insured banks will not accept cash from cannabis companies. Zucker says while there are new options such as independent banks, cryptocurrencies and prepaid cards, most dispensaries are left to operate in cash with tens of thousands of dollars on site at any given time.

"It's causing unnecessary risk for the companies and their employees by having to hold large sums of cash and having security teams just to keep them safe," Zucker says.

Since companies cannot take out traditional business loans, the banking issue has also limited access to capital for expansion. Fish says most cannabis businesses are financed internally or by private investors. "There are a lot of [private investors] who want to jump into the industry and be a part of it," he says. "But there is no such thing as a legitimate bank loan."

Federal law does not allow cannabis to be transported across state lines. Even in border states

dispensaries were using spa software to manage their operations, he says. Green Lion currently has an investment in FlowHub, a cloud-based POS system designed specifically for the cannabis industry which enables dispensaries to manage their inventory and compliance by automatically handling all reporting with state agencies.

"The industry is on the way there, in terms of being in better shape on the software side from a retail perspective," Zucker says. "As the adult-use market grows, I think the companies out there will continue to improve, and more players will pop up."

Like many in the industry, he believes the balance is tipping so far that the federal government will have to respond. Many more states are considering legalizing medical use in the coming year, and Vermont, New Jersey, Arizona, Michigan, Rhode Island and Connecticut are likely to put recreational initiatives to vote in 2018.

Zucker feels confident that within the next five years or so, marijuana will be removed from the list of scheduled substances, at which point it will be decriminalized on a federal level and offer the retail industry an entire new category.

"The goal is to continue to get states on board, and as we get medical, the states generally realize that there's no reason for this product that everyone is using everywhere to not be safe, regulated and taxed for adults," Zucker says. **STORES**

Craig Guillot is based in New Orleans and writes about retail, real estate, business and personal finance. Read more of his work at www.craigguillot.com.