Institute of Corporate Directors

Podcast Transcript: Be It Resolved The public company model no longer serves Canadian business

Rahul Bhardwaj (00:03): Welcome to Be It Resolved, a podcast where bold ideas meet courageous leadership. I'm Rahul Bhardwaj, President and CEO of the Institute of Corporate Directors in Canada. In each episode, I speak with experts to delve into pressing issues, impacting directors and decision-making in the boardroom.

My guest today is Drew Schardt. He's the vice chairman, head of investment strategy, and co-head of Direct Equity Investments at Hamilton Lane. Based on his experience in global investment strategies, banking, and private holdings, he'll share his insights to help us all better understand the impact of the public company model in the US and Canada.

And today's resolution, well, it's a bit provocative. Resolution is be it resolved the public company model no longer serves Canadian business.

Today, we're gonna explore the public and private company model and see what the director should be considering as business leaders to address what appears to be a dramatic shift in value creation from public to private markets.

And to get that started, I'm pleased to welcome Drew; great to have you here today.

Drew Schardt (01:16): Thanks, Rahul. Happy to be here.

Rahul Bhardwaj (01:18): So Drew, we've had a chance to talk about this and it's going to be interesting to try to focus our conversation today, but let's start with public company. So most listeners would know that there was a time when you heard IPO. Public offering, everybody get excited, a lot of businesses would consider that to be an extraordinary accomplishment of value creation for the early shareholders. Maybe you can talk a little bit about the early days of capital markets and IPOs and how that's changed a bit since then.

Drew Schardt (01:47): Yeah, listen, I don't think the IPO is gonna go away, but I think to your point, you know, if you think back to sort of the late '90s, early 2000s, that was the sexy hot thing to do, take your company public. And I think the key here is how the corporate investible landscape has evolved. And what has happened primarily is there's just been a greater shift to companies either becoming or staying private and staying private for longer. And part of that evolution is the ecosystem itself.

There's just more pools of capital IE, private equity, private credit, private real estate and infrastructure that weren't around back in the '80s and '90s in the scale and volume that they are today. And so that financing ecosystem, if you will, has become a alternative to what used to be, if I wanna monetize my investment, if I wanna create liquidity, I needed to go public, that's no longer the case because of that broader financing ecosystem.

And then if you get into the differences of being a public company versus being a private company and the governance models behind both of those, they are just dramatically different. And again, I think that's reflected in what you've seen in terms of the numbers of companies. And I'm happy to go through the numbers of how many companies were publicly listed back in the 2000s versus what that looks like today.

And the punchline is the scale has shifted dramatically towards the ecosystem being much heavier towards private companies.

The quick stat is, if you look at companies globally that have a 100 million dollars of revenue, for example, about 90% of companies that fit that profile are private companies; just over 10% are publicly listed companies. So that number gives you a sense of the potential ecosystem in the shift we've seen in the last 20 to 25 years to companies; not only there are more private companies that are growing, but a shrinking public market ecosystem.

Rahul Bhardwaj (04:08): So that's a lot to unpack at a great start. Now in a minute or two, I'm gonna invite you to tell us a little bit about how the public markets have changed and the rise of the private companies here. But you did open the door to the governance model. So let's just at a high level talk about the governance model.

So what do directors need to be thinking about when they're in public companies? We've got the basic, you know, your fiduciary duty is still your fiduciary duty standard of care, oversight of culture, strategy and risks, but you're in a completely different regulatory environment now as it relates to the issuance of those shares.

And Drew, I sort of chuckled, a lawyer once showed me what the securities regulations look like in Canada in the 1970s, and it was more like opening a restaurant menu. Whereas if you look at what those regulations are today, it's like reading war and peace. So things got a lot more complicated. Would you agree with that?

Drew Schardt (05:00): You hit the nail on the head, Rahul, and I think our company is a good example. We invest only in private markets so take everything I'm saying with a grade of salt. But we happen to be, from a structural standpoint, a publicly listed company. And one of the big things that happened when we went public eight or so years ago is there's a lot more lawyers, compliance folks, accountants moving around. And so I think you're hitting on a critical aspect of what it means to be a board member of a public company versus a private. And it's not that you don't have oversight or regulation, it's just the amounts of regulatory requirements, the oversight, the accounting requirements, the cost and complexity that comes with managing that.

And then you think about the velocity of your reporting requirements, you're under a heavier level of scrutiny from investors, thousands of investors who have access at any time to your public shares. That's a much different prism of oversight and again, complexity to manage. And as a board member, as a manager, you may be thinking about decision-making while strategic priorities are, is it always important when you have to manage decision-making based on day-to-day, month to month, quarter to quarter reporting requirements and oversight, That maybe creates a different decision-making prism than say the private model where you're not under that same level of oversight potentially but at the same time, you're not in wide view of everyone to see your every waking move at every second, every quarter, every week.

That allows you as a decision-maker to think with a long-termism as a private company, as a private board that, you know, again, I think most public boards would say they think of the long term, but it's hard to ignore just the velocity of reporting and scrutiny that you're seeing and the amounts of regulatory constraints and requirements as a publicly listed company. And that's a huge difference.

Rahul Bhardwaj (07:10): How about thoughts on director independence as well in the public company environment?

Drew Schardt (07:14): Listen, I think the public and private companies both have independent directors. One of the big things is you have to separate management or insiders who in theory know the micro, they know the business, they know the operating the day-to-day aspects.

To me, the biggest value or one of the biggest values of independent directors is just the diverse range of perspectives they can bring. They typically are knowledgeable on an industry or a company or a sector, but they may not be tied down into the minutiae. So they can take a look and help you navigate the bigger picture of things. And certainly relevant today with all that's going on globally, where you need to not just focus on the micro and your industry, but also sort of the geopolitical, the global context of what's happening on the trade side, for example.

I think independent directors historically can bring some external perspectives to help the management teams navigate that. That's also valuable on the private side. But one of the big differences I would say, between those two models in terms of the board construct and the equity ownership is public companies obviously have thousands upon thousands of holders of the equity, therefore the board representation may be a little bit more mixed.

One of the benefits of the private side, if you think of the private equity buyout space, is you have a much more concentrated equity ownership. Typically one private equity group owns the company. And so, when you think about back to the board, the construct, the decision-making, it may be more efficient to make decisions for the long-term with just a more concentrated, dare I say, sophisticated private equity investor base that knows operational, they know financing; not to say the public boards don't have that, but there's just a much more disparate base of equity ownership that has implications to how you might set up that public company board.

Rahul Bhardwaj (09:21): Right. So it sounds like a series of trade-offs. Now we're gonna come back to these trade-offs and at the end, have a bit of a conversation about, you know, in these turbulent times we're living in, whether a public companies or private companies are perhaps broadly speaking, is one better positioned to actually have successful strategies under these environments.

But before we get there, you had some insights around the numbers and the shift of public companies or listed companies back in the '90s compared to where we are now. And maybe you could share some of that with us.

Drew Schardt (09:53): Yeah, and I think it's not specific to one region. It has been a global phenomenon, which is, I'll start with Canada. So if you look at the Toronto Exchange and look at operating companies, because there's some things like ETPs and ETFs that aren't necessarily corporate entities, they're sort of baskets of indices or financial securities. But let's just look at companies with boards that are public on the Toronto Exchange, peakish kind of going into the GFC. About 1200 operating companies on the Toronto Exchange today that number declined. It's down about 42%. It's something just over, I think 700 as of today, companies listed on Toronto Exchange.

Same thing here down south where I'm sitting in the US, looking at companies in the US that have a 100 million of revenue that are listed 8,000 public companies in the US in the two thousands, late '90s at the peak it was about 8,500. Today that number about 4,000 public companies. So almost cut in half.

And again, so I'm biased, I'm a private market investor and work in a private market company. But if you just take that as an independent vote of where investors are putting more capital or where companies management boards are structured, it's clearly giving you the view of a shift towards the private ecosystem. We can go through the reasons that is about making decisions, operating for the long-term, and avoiding some or all of the scrutiny that comes with being a listed company.

Rahul Bhardwaj (11:31): So let's get into that a little bit because I think to understand that extraordinary shift is to try to get inside the head of investors to say what are they seeing in terms of the value creation opportunities inherent in private companies.

The easy thing to do is to fall back and say, wait a minute, you know, the regulatory environment just got so burdensome that going private is the way to go. And you know, I'm mindful, I was at an event with a very well-known CEO in Canada who runs a company with both a lot of pension funds and other large private investors and made the point that the disclosure requirements that sophisticated private investors are looking at is really not that much lower than the bar that it would be as a public company, which I thought was quite an interesting statement to make. So you might agree with that or disagree with that, but it's clearly not the only factor; there seemed to be some other ones. So how would you like to address that?

Drew Schardt (12:26): Listen, I think you're absolutely right and that CEO is right in that being private, it had this stigma that, oh, there's no oversight or is so risky, that's absolutely not the case. And again, when you're talking about what I'm kind of putting most of this discussion around companies of size and scale that are mature, 100 million plus of revenue, the quote unquote buyout space, you're subject to all the same financial agencies and regulatory bodies that most public companies are. The difference really comes mostly around the reporting requirement. Certainly you're not pricing in real time the securities or the ownership of the underlying investments on the private side as frequently, but other than that, there's still a heavy level of oversight and scrutiny. And so I don't think it's as simple to say as, well, we don't have to deal with regulation if we're gonna go private because I can tell you that is absolutely not the case from firsthand experience.

Again, I think the difference to me is if you are a management team and you have an investor group coming in and they say to you, there's a lot of volatility, uncertainty, complexity in the world today. We wanna go from point A to point B with this company, there may be some bumps along the way. Wouldn't you rather not have the public lens sort of looking at you every second of every day or reporting with an earnings call where anyone can ask you any questions where all your competitors see all your financial information

On the private side, it doesn't mean you're managing the business necessarily differently. It just means you don't have to share all that financial information. You're not having to sort of do public earnings calls and that to a management team that to a board can really free you up in some ways to do what you're supposed to be doing, which is grow shareholder value consistently and for the long term is what the mandate for most boards are. And so I think just that being out of the public eye is a big difference for the private model.

And then you factor in, and we can go down this thread of what do private financiers or a private equity group bring that maybe if you have disparate equity holders or you don't have, you know, a single large entity, there's really big differences that show up in the operating, the performance profile, the fundamentals of what those businesses can generate. And then the data sort of would back up and happy to go into that revenue earnings, the performance you get from private companies versus what you're able to generate on the public side. And if you look at it, the private markets have pretty consistently outpaced revenue and earnings growth of listed companies or listed indices broadly. And that's something I think investors around the world are seeing in that ecosystem.

Rahul Bhardwaj (15:30): That'll be helpful. So give us the top line on that, but where I wanted you to take that conversation though is what's the impact that has on composition of a board and let's say a private company environment. So as a private, as a PE investor here, you know, when you start to think about putting a board together to achieve the type of outcomes that you're gonna be describing now, does that give you a different lens on board composition than you might find it in a public company environment?

Drew Schardt (16:00): Listen, I think the public companies go through an overwhelming amount of rigor in selecting their board members so I'm not dismissing that. But when you think of the private equity world, these are professional investors that, take your typical private equity firm or fund, they're gonna invest in 20 different companies, they're gonna have industries that they specialize in over the, you know, again, 20 different companies over the course of five years. They're experts or specialists typically in two to three main sectors, those are the types of companies they're investing in. That comes with a huge networking synergy when you're talking about owning multiple companies within an industry across different industries. That acumen and that base is pretty appealing. Not to mention these funds and managers have track records where they've done well, there's times they haven't done so well, it's not all roses all the time. So they know which management teams, which board members, which independent members have added value in their own track records, historically.

You look at a public context, I mean it's all very insular, right? There isn't that same portfolio of companies to sort of pick and choose from. And while you may understand an industry, it's a different sort of numbers game when it comes to the networks that many of these private market investors can bring. Not to mention the private equity firms own capabilities in terms of their professional operators. They know how to manage businesses. Again, governance-wise, they control the business, they control the direction, the strategic priorities, they can create alignment with equity (we can go into what that means) versus the public context.

But this is what these managers do professionally. And not to mention they're all pretty much capital markets experts. When you think about managing the capital structure, managing the debt associated with the business, managing acquisitions, that's what these investors do and that's how they construct the boards.

I think most public companies, it's a mix of how they put the board together. It's a mix of where independents come from, but it's just a different setup because there isn't usually one group that's controlling how that board is set up. It's usually to manage the vastly different groups of despair investors, which is a totally different governance model than what you have on the private side.

Rahul Bhardwaj (18:35): Right. So we've been talking about the variety of trade-offs here and we've been focusing a lot on advantages and disadvantages, and frankly probably more on the advantages of private companies, which perfectly fine here.

So let's look at the disadvantages side just a little bit. And if I threw out the notion of dual class shares, poison pills, you know, what are your thoughts on those in that context?

Drew Schardt (18:54): Yeah, listen, I think there's a lot of advantages to being public. You have a liquid stock, it gives groups the ability to, as a retention tool, incentivize or compensate in addition to just like a base and bonus salary. Giving someone liquid stock is tangible, whereas private companies, the value is created once every quarter and you may have shares as a manager, as an employee, but it's less frequent. So I think that liquidity trade off is certainly real.

I think there's certainly, if you look for example in the tech, in the services space, in the consumer space, there is an allure to being a publicly listed company. It's a brand recognition. It helps get visibility, which are quite important in the context of a lot of those industries. So I would tell you that is hugely important in terms of attracting talent.

The one difference I think, I'd say an advantage the public markets or public companies used to have was around the capital markets; meaning in the late '90s, 2000s you needed to raise capital. You know, the board was deciding how do we want to treat the balance sheet. As a public company, it was easier to either just issue more shares, so raise equity capital, you obviously have a liquid market to do that. You don't have that with a private company because it was a much smaller ecosystem and you had better access to the credit markets as a public company, higher quality borrower, names that were tracked and sort of rated. And so it made it relatively efficient to get an access new capital. So that was a huge advantage.

I think that third advantage that I went through has slowly dissipated because of, back to what I started with, the ecosystem of private market investments. It used to just kind of be, there were some VC shops, venture capital, some buyout shops.Now there's not just venture capital, there's early stage, mid stage, late stage, A, B, C, D, E, F, round investors, there's all sorts of striations.

Same thing on the buyout side, different mid cap, small cap, large cap investment groups. And so what it means as a company, as you grow, what you used to be dependent on was getting public to access that capital and capital markets, you don't necessarily need to do that anymore because the financing environment on the private side is just much wider, much more striated. Again, different managers doing different things at different stages of the company evolution.

So I think there are trade-offs that favor sort of liquidity, that favor the ability to maybe have an enhanced brand awareness if you're a company in one of those sectors I mentioned. And so those things shouldn't be dismissed either. And especially if you're thinking, you know, you're a company that wants to be able to provide liquidity to your shareholders, that's a key facet for boards to manage. And in the public context with lots of different shareholders, obviously it's very different than when you have one shareholder who's sort of making and deciding when there's liquidity or when there isn't. So that's another you could look at as a negative of the private company. If you're an employee looking for liquidity, you're not really able to get that like you would in a public market context.

Rahul Bhardwaj (22:12): And now even folks like me can participate in this private markets and we couldn't in the past. We're gonna have directors that are going to be listening and wondering if there's significant differences. And I think we've highlighted a number of them, which are really helpful. One area we didn't probe though, but I'm sure it's gonna be on top of some of their minds, is how about board compensation? Is there a notable difference in compensation for board members in the private company environment versus a public company environment?

Drew Schardt (22:42): Yes, I think there's no question. Listen, if you look at the public world, and again, I think this is part of the changing ecosystem, and this is a big difference of why investors have shifted more capital to private side, there's been more concentration in terms of performance weight of indices, whether you're talking about a Canadian Index, a US, or a global index, fewer companies on the public side are generating a greater share of the performance, meaning the stronger performance. For example, in the SME 500, the magnificent seven generating almost all of the growth, all the value creation, the sort of other companies are more flattish.

If you look at the last 12 to 18 months in terms of their performance, their revenue growth, that concentration sort of is different and it's led to just bigger companies. And certainly when you're talking about compensation being a mid to large cap company in the public side, which is most of what those indices are, your compensation for directors is typically higher.

Most of where the private markets are investing are in, you know, again, if they were publicly listed companies, most of the capital would be considered small cap stocks. If these companies that most of the ecosystem, the private world, you know, you're talking about companies that have 50 to 2-300 million of revenue is where the lion's share of the capital is going on the buyout side.

And so when companies are at that size and scale, cost and margin are maybe a little bit more, a little less flexible when you have certainly high governance costs. The trade off though is you don't have all of the administrative requirements that a public company has, obviously with quarterly reporting and you know here in the US, Sarbanes oxley and some other things that are required in the post GFC world. But I would say that on par it comes back to the sizes of the company. And I think it's different just because most of the universe of private investors tends to be smaller than your typical public company board.

Rahul Bhardwaj (24:51): Whether it's public or private these days doesn't really matter. You're equally busy and your agendas are just as packed as ever in this world. Listen, Drew, it's been really great having this conversation with you. We've got a resolution on the table that I'm gonna ask you on which way would you vote? Just a reminder, the resolution: is be it resolved, the public company model no longer serves Canadian business. Got a feeling I know which way you might vote, but which way you gonna go?

Drew Schardt (25:18): I used to have an economics professor, whenever you asked him a yes or no question, he'd always answer, it seemed like with the answer of it depends. And here for your question, I'll say it depends. It depends on the priority of the strategic direction and the governance and the board, the board's mandate of what they're trying to manage for. That may vary depending on industry, it may vary depending on short-termism, geopolitics, and/or needs for liquidity.

And so I would say it's important as a director position, especially an independent director, to really fully grasp, okay, what are the strategic directions? And in today's uncertain, complex, volatile times, what is the general decision-making look like with that macro backdrop?

There are benefits and trade-offs to both. And as I said, if I was forced to vote, I would say the private model just aligns better. The shareholders, the management and the directors, than the public model. And I'd say the numbers of companies in the public versus private realm and the way that has trended over the last 20 years, that if that's an independent vote, it would say companies are favoring being private and staying private for longer.

Rahul Bhardwaj (26:49): Well that sounds like an abstention to me. We're not gonna let you do that. So I take that as a no, and that's perfectly fair. You're not the first to go that route.

But to our listeners, I really hope you enjoy today's episode of Be It Resolved and that you've deepened your boardroom insights to stay ahead of emerging trends.

If you enjoyed the episode, please subscribe, rate, and leave a review on your favorite streaming platform. From the Institute of Corporate Directors in Canada, I'm Rahul Bhardwaj. Until next time.