

CLEAR-SIGHTED CANNABIS STRATEGIES

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By Les Gombik, Drew Railton, Kathy Ventura, Adam Cotterall

EXECUTIVE SUMMARY

The short history of the legalized cannabis markets in the US and Canada has been marked by rapidly changing market dynamics. In this article, Caldwell Partners executive search consultants outline the market development stages and opportunities, with an emphasis on leadership imperatives, such as required talent profiles, compensation strategies in a developing market, and talent management practices during business transition. Included topics:

With cannabis legal in Canada and 11 US states, a “gold rush” mentality ensued in early 2019, then fizzled by late summer, as profits proved elusive. After significant capital spending, investors continue to call for tighter business controls and a show of profitability.

The market potential remains huge. By one estimate, the legal cannabis market in North America is expected to grow at a 28% CAGR, to US\$35 billion by 2023.

By fall 2019, a sector reset and redirection is underway. The wide-open cannabis market still has no dominant player. Canadian and US companies alike sharpen their strategies to win market share, with growing attention paid to the outsized opportunity in the US.

As founders and early sector leaders step aside, cannabis companies in the US and Canada revisit their talent strategies, consider talent upgrades, and build out teams. Beyond the CEO and CFO, functional leadership in demand includes strategy, compliance, R&D, M&A, investor relations & capital markets, and marketing & branding professionals, among others.

A cannabis sector cash crunch amplifies compensation challenges, with later hires being awarded less generous compensation packages---and stoking some office tension.

Cannabis companies grapple with the talent management challenges of rapid growth and business transition, as well as recruiting from related industries.

With a growing cannabis sector practice in the US, and as the sector's dominant executive search firm in Canada, Caldwell Partners offers deep-seated expertise on compensation strategies, building leaderships teams, and managing talent through business transition.

The rush for cannabis gold in North America is proving to be a roller coaster ride for many companies in the sector. With cannabis legalized in Canada, as well as in 11 US states (and medically permitted in 33), the cannabis race was at full throttle during early 2019. By late summer, the picture had changed dramatically, with profits proving more elusive than expected. Like the Gold Rush of 1848, the cannabis rush has drawn many early market entrants, featured a certain level of market frenzy, and if the gold does not pan out, may send more than a few cannabis corporate hopefuls home empty-handed.

Despite recent stumbles in the sector, the market potential still could be huge. By one estimate, the legal cannabis market in North America is expected to grow at a 28% compound annual growth rate, to US\$35 billion by 2023. Nice work if you can get it. Even in its infancy, the cannabis market already overshadows many other business sectors. For instance, recreational cannabis (including estimates of non-legal commerce) in the US draws more leisure dollars than either doughnuts or videogames. Both its population size and its more favorable growing climate have always made the US the largest potential cannabis market in North America—and nothing has changed there.

Yet, the sector presents both opportunity and challenges. Investors are growing louder in their calls for tighter business controls and a show of profitability, while some companies—dreaming big—have already spent significant capital on real estate investments and acquisition strategies. Meanwhile, the stock market has been moving in lockstep—punishing even profitable companies when sector leaders stumble.

Tyler Robson, CEO of Valens, said, “Cannabis companies are seeing access to capital dry up as investors become more discerning in their evaluations. Management teams are being forced to start thinking differently about how to deploy their resources to produce the greatest return on investment. Furthermore, with Canadian consumers able to buy edibles, concentrates and vape pens starting in December 2019, investors will expect to see meaningful improvements in top and bottom-line results. In a sector where access to capital is vital, using cash wisely is the difference between success and failure.”

As investor impatience mounts and high-profile stumbles in both the U.S. and Canada give the sector a black eye, companies increasingly feel the pressure to ensure that the right people are in the right chairs at the right time.

THE CANNABIS COMPENSATION CRUNCH

Compensation has become a particularly difficult challenge in the cannabis world. In the early days, many executives were lured into roles with stock options and founder's shares. Yet, as companies mature and can no longer offer as many options to executives, the upside for more recent hires becomes limited. Companies seeking to preserve cash, complete operational plans, and meet investor demands need to be careful in issuing compensation package stock options for restricted stock. And yet, attracting top talent is critical to competing in the marketplace and achieving business goals. These challenges become amplified as anticipated profits diminish and executives find themselves sharing more limited wealth.

Meanwhile, top talent from large corporations are accustomed to receiving large base salaries along with short-term and long-term bonuses. However, smaller cannabis companies tend to pay conservative base salaries, with bonus pay tied to achieving significant company growth targets. As high-profile stumbles in the sector continue, many leaders fear that hitting those targets will be difficult, discouraging executives from both large and small companies, who are not wired to take on that risk.

Although side-deals and special one-off packages may work in the early days, as companies mature it becomes ever more challenging to attract the high-caliber talent needed, while retaining the capable people that led the company to that point. Key learnings from fast-growing companies in the tech sector could be applied.

With our extensive work in the sector in the early days in select states in the US, and now as the dominant executive search firm in the sector across Canada, we at Caldwell see that navigating these early challenges will require companies to have a clear-sighted approach to setting business strategies—including strategic talent management. As some founders and early leaders are now stepping aside, this is a good time for companies to evaluate talent team needs, whether building a cannabis company from the ground up, re-envisioning the business for the legalized market, or recalibrating based upon early lessons learned.

Additionally, as the profitability crunch causes anticipated big paydays to evaporate, compensation in the cannabis sector has also become a thorny issue—and leading priority—for companies both large and small (see sidebar, “The Cannabis Compensation Crunch”). Caldwell works closely with client companies across North America to advise on compensation strategies, building or upgrading talent teams, and ways to best position the company for sustainable success in the cannabis rush..

TURNING THE SPOTLIGHT ON CANNABIS LEADERSHIP TEAMS TODAY

As more companies consider talent upgrades, a look at the current composition of leadership teams in the Canadian cannabis sector is revealing, given their status as the early entrants in a legalized national market. In early summer 2019, Caldwell reviewed public information regarding the 50 largest publicly listed Canadian cannabis companies, which vary significantly in size, business maturity, and strategic goals regarding the medical or recreational market segments. Admittedly, this data provides only a snapshot, taken during a time of rapid sector change and growth.

Not surprisingly, all 50 companies have CEO and CFO leadership. CEO backgrounds tend to be in life sciences, investment banking, or as entrepreneurs, while a large portion of the other executives come from the CPG and consumer products sectors. Some 90% of the executives have LinkedIn profiles (so they are not hiding their cannabis connection.)

About 65% of the companies have leaders in operational roles, 40% have marketing leadership, and 40% have sales leaders. Just over 25% of the companies have a scientific/R&D leader in place. A legal professional is present in 40% of the companies—this in an industry with complex and evolving regulatory requirements. Also notable for this fast-growing sector: only 7 of the 50 companies have an HR leader on board to help build and integrate the growing workforce.

This data would seem to indicate that many companies might be on the cusp of bringing several functional leaders on board, with the opportunity to plan and hire for a coherent and synergistic leadership team. This is a unique—and valuable—opportunity for any growing company. That said, the recent cash crunch and focus on profitability is leading many organizations to be much more careful and strategic about senior hires than they were just six months ago.

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BUILDING FROM DIVERSE TALENT PROFILES

In any rapidly changing business sector, business leaders need to be comfortable operating in an ambiguous environment. They need the entrepreneurial attributes of being able to move quickly, thrive with the unpredictable, and embrace change. These leaders tend to be highly intelligent, nimble, and adaptable. The CEO, head of strategy, and other visionary roles in the leadership team need to have these attributes in spades.

And like all businesses, cannabis companies also require other diverse executive skillsets. As cannabis is a highly regulated product, these companies need to be extremely serious about compliance and security. This calls for a leader who might be much less entrepreneurial, and instead, highly experienced in a regulated industry. With North American cannabis regulation currently in constant flux, many companies may not yet fully understand the scope and complexity of the security and compliance issues. For start-ups, this can be a particular challenge, and unlike, say, a technology start-up, cannabis companies have public safety issues to address.

On the medical side of cannabis, companies may need a chief scientific officer or head of R&D. While the pharma sector offers leaders with the necessary scientific skillsets, certain personal attributes will also factor into the success of this leader at a cannabis company. The approval process for cannabis products is quite different than in the pharma sector, not to mention the fast cadence of development in cannabis versus pharma. Cannabis requires a scientific leader with an entrepreneurial streak.

Highly reputable investor relations and corporate communications executives will be critical in the fledgling cannabis sector, as corporate reputation plays such a significant role in conveying trustworthiness and integrity to the investor community. This need is amplified for companies migrating from medical to recreational cannabis.

And astute and creative marketing leaders can have a significant impact in building the brand differentiation and consumer preferences that are essential for competitive position. This is especially true in the U.S., where states often have less restrictive cannabis advertising regulations than are present in Canada.

Among Canadian cannabis companies, given the many former investment bankers in the CEO seat, it is not surprising to find a COO or other operational leaders on the team, with a good number coming from the consumer products sector. These operational leaders may even ascend within these companies as some banker-CEOs cash in and transition off to find the next opportunity.

Some Canadian cannabis companies take the approach of recruiting from what some view as the most experienced talent pool available - the US legalized states, especially the first states to do so. Westleaf of Calgary, for example, hired their chief operating officer, chief legal officer, chief development officer and a cultivation director from Colorado. While all of these individuals have both medical and recreational cannabis experience, the COO and CDO come from diverse but applicable backgrounds - the former in both cancer treatment centers and R&D at NASA, and the latter a LT. Col. in the USAF who spent time as a test pilot. Both backgrounds demand a scientific rigor and technical discipline that would match the pharma sector.

Additionally, Westleaf is constructing a large-scale extraction and processing facility to match the second wave of cannabis legalization and the introduction of cannabis-infused consumables, beverages and topicals. For those product roles, Westleaf has recruited from the food-processing sector, which shares similar regulatory attributes around sanitation, contamination risks, and packaging and shelf life challenges.

A SECTOR RESET OPPORTUNITY

Market opportunities abound. Still, one year into cannabis legalization in Canada, this wide-open market has yet to deliver the hoped-for results. Investors are feeling apprehensive after spending and investing, with still no clear sightline to reliable revenue and profits. Compliance costs are pressuring pricing, cannabis consumption levels have been below targets, and consumers have yet to demonstrate any brand awareness, let alone brand loyalty. Some companies have responded with layoffs and financial impairments.

And yet, as a number of sector leaders note, that bad news also represents the opportunity for future good news amid a period of sector reset. The competitive space is still wide open, without a dominant company yet emerging in the market. The December 2019 entrance of edibles and topicals in Canada offers a chance to build sales and market share. And the current talent turnover may facilitate strategic leadership hires, perhaps including experts in product differentiation, marketing and branding. As retail strategy advisor Paul Wilson stated, companies will need to develop a “grow what will sell” versus “sell what will grow” approach to the market, that places the customer first.

And the larger U.S. opportunity remains. While federal legislation to legalize cannabis in the US does not appear imminent, the long-term prospects for growth of a significant cannabis market in the US look promising, given legalization by 11 states. In September 2019, the House passed the SAFE Banking Act to alleviate some of the banking obstacles attendant with classification of cannabis as a Schedule 1 drug. The Senate has been expected to address the legislation by year-end. Restrictive tax implications and even payroll complexities remain for US cannabis companies. Yet CBD product is readily available across the US, and cannabis is medically permitted in 33 states. Investors and talent alike are giving US cannabis opportunities a second look.

Several factors are driving the talent turnover and upgrade that is underway among cannabis firms. Prior to legalization, the talent pool was limited, with some executives morally concerned

about joining a cannabis company, or worried about any black mark it might put on their reputation. With that concern now significantly reduced, companies can consider a much

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broader range of candidates for their leadership teams. Interestingly, legalization in Canada shifted candidate opinions in the US too.

At the same time, some founders and other early leaders are now stepping aside. Other individuals who joined the cannabis sector more recently, simply hoping for a big payday and a fantasy job are moving on, given the dual realities that there probably won't be a big payday, and it is a real job.

During this time of leadership transition, the sector is now drawing leaders who relish the chance to help build an industry or company from the ground-up, establish the standards and infrastructure, and stake the claim. Leaders who have a track record of turning around challenged enterprises are in particularly high demand.

THE TALENT CHALLENGES OF TRANSITION

In the race to define the sector's winners and losers, cannabis companies may find themselves reacting, recalibrating, and transitioning, all while striving to capitalize upon new opportunities. The business model itself may be in transition, shifting a company from a therapeutic model to a retail company. Rapid growth may lead to dramatic shifts in company culture.

Moving from three people in a garage, to a 50-person business, to a professionalized company with policies and procedures might happen in a matter of months versus years in today's cannabis sector. The dynamic nature of a fast-growing company and shifting culture can leave both long-time and incoming talent feeling out of step. One cannabis sector executive described the tension that can exist between the incoming professional managers now applying business best practices and processes, and the individuals who bootstrapped the formation of the business, having never previously worked in a corporate setting. Pair these differing mindsets with a growing disparity in compensation packages between long-time and incoming employees, and the tension mounts.

As another client shared with us, many individuals join cannabis companies simply to get a foot in the door. But those coming from more

established businesses to a startup cannabis company can become frustrated by the cadence, lack of established processes, and general chaos around so many areas of commercial activity. For this reason, it is important to offer candidates an honest perspective on what they will face once inside a cannabis company.

The level and nature of the professional challenge also should be conveyed to candidates. As one candidate shared: I wonder whether the depth of activity will be challenging enough for me. Having spent time at a clinical-stage biopharma company, I know how different that is compared to working at a much larger, complex and fully operational commercial company. Hiring organizations will need to consider such perspectives and know how best to respond.

When recruiting talent from one industry to another, it is useful to identify similarities between the companies and roles. Are the industries similar in nature: highly regulated or not, mature or emerging? Do the companies serve a similar client: consumers, small businesses, large organizations? And is the professional mandate similar: a turnaround, a rapid growth scenario, a new product launch, a new market entrance?

THE WORLD IS WATCHING

As frontrunners in legalized cannabis, Canadian companies have had a unique opportunity to blaze the trail, claim early market share, and build an enduring business. But early entrants into a fledgling market also tend to face significant stumbling blocks. Now the U.S. market is drawing increasing investor attention. There is opportunity, but the challenges are also front and center.

The talent challenges of building and growing a business are many: what is the right time to add a VP of HR to the team, or to trade out an executive for the next tier of professional leadership? What are the competitive ramifications of not taking those steps? What are the best

practices for attracting and retaining top talent, especially amid compensation constraints? With investor impatience for profitability mounting, even as stumbles and departures in the sector ramp up the pressure, companies that want to be among the winners in the cannabis sector need the right leadership talent at the helm.

U.S and Canadian cannabis companies alike are destined for a wild ride in the months and years ahead. There will certainly be acquisitions (some planned, some not), failures, and many successes. And as other countries grapple with the cannabis question, the world will be watching the North American experience.

ABOUT THE AUTHORS



Les Gombik is the managing partner of Caldwell's Calgary office. With more than 25 years of executive search and human resources experience, Les has a broad perspective on the most pressing talent issues in executive management today. His particular focus is on board and senior executive positions for public companies and equity-backed enterprises within the energy, industrial, life sciences, retail and financial services sectors.



Adam Cotterall is a partner in the firm's Vancouver and Toronto offices, working with clients across North America to build their leadership teams. Specialized in recruiting executives into emerging and transforming companies, Adam is also called upon to recruit CFOs, CIOs, and CHROs across a variety of sectors. Leveraging 15 years of human capital consulting, clients count on Adam for strategic counsel, service excellence, and a professional approach that leads to exceptional outcomes.



Drew Railton is a managing partner in Western Canada. Drawing on more than 18 years of experience placing senior executives and board directors, he is regularly sought by clients for his expertise in board, CEO and senior executive recruitment. Drawing on his extensive search, director and philanthropic experience, Drew is able to provide great insights about the balance of skills match and culture fit to clients and candidates alike.



Kathy Ventura leads Caldwell's Marketing Officers, Corporate Communications and Investor Relations practices in the US, and recruits marketing, digital, growth and customer experience leaders for clients across all industries. She has extensive experience recruiting leaders to clients in both established and emerging industries from retail and consumer, to professional services, healthcare, technology, fintech and life sciences/cannabis.



WE BELIEVE TALENT TRANSFORMS

At Caldwell we believe Talent Transforms. As a leading provider of executive talent, we enable our clients to thrive and succeed by helping them identify, recruit and retain their best people. Our reputation—nearly 50 years in the making—has been built on transformative searches across functions and geographies at the very highest levels of management and operations. With offices and partners across North America, Europe and Asia Pacific, we take pride in delivering an unmatched level of service and expertise to our clients.

Understanding that transformative talent is not limited to executive levels, our Caldwell Advance solution focuses on emerging leaders and advancing professionals who can also have a profound impact on a company's ability to turn potential into success. We also leverage our skills and networks to provide agile talent solutions in the form of flexible and on-demand advisory solutions for companies looking for support in strategy and operations. Also, we are a leading licensed certified partner of The Predictive Index (PI), an award-winning talent optimization platform with a suite of talent strategy and assessment tools that – when integrated with our search process – helps clients hire the right people, then manage and inspire them to achieve maximum business results as fast as possible.

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