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Publicly Traded Cannabis Companies: To Be or Not To Be?

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The cannabis industry is in distress. Despite continued market expansion and the increasing number of states legalizing adult use, business owners still grapple with lingering supply-chain issues from the pandemic, an oversaturation of product, inflation, taxes, a lack of legal access to traditional banking services and overregulation.

It remains an industry in flux, slowly maturing despite those inhibitors, and larger companies with the staying power to endure the road bumps are becoming more involved. Pharmaceutical, alcohol and tobacco companies have quietly invested in the industry and the lure of going public is looking more and more attractive to cannabis companies in a position to make the jump.

Whether your company needs capital to expand or you're eyeing an exit strategy and seeking to build the value of your brand, taking a cannabis company public requires a plan. Here's some corporate-law insight about pros and cons to cannabis IPOs.

Why Would a Cannabis Company Want to Go Public?

There are several objectives in taking a company public, whether it's cannabis or another sector. Among them:

- Raise capital to fund operational growth
- Attract new investors to reduce or eliminate corporate debt
- The ability to dramatically increase market share
- Build brand visibility and value

Believe it or not, going public can also help with attracting and retaining employees thanks to the increased prestige of the company and stock options—and decreased turnover and training expenses also help the bottom line.

Of course, there are downsides of going public too. The cost of the legal and accounting fees just to get an initial public offering (IPO) compliant and ready for launch can be substantial.

There's also the hefty time commitment and resources needed to navigate the regulatory filing process, as well as strict accounting standards to follow. Quarterly filings to the U.S. Securities

and Exchange Commission (SEC) as well as the agency's 10-K, 8-K and other disclosures have to be made in many different situations.

Why a Cannabis IPO Is a Different Consideration

Any cannabis company that is publicly traded should also expect to face increased scrutiny of its operations and governance. SEC filings of any publicly traded cannabis company include contracts, a list of investors and regulatory compliance records. The heightened degree of transparency can lead to internal strife and shareholder lawsuits, such as the 2019 suit brought against MedMen that alleged a complicated breach of fiduciary duty and a recorded pattern of the CEO and president “rewarding themselves to the detriment of other shareholders in the company.”

Cannabis businesses that go public also face added pressure from investors, shareholder boards and the market itself to achieve short-term success that can be detrimental to long-term planning.

Shareholders tend to have less appetite for risk and are hyper-attuned to the sensitivities of the market. With an urgency to drive up the stock price, business leaders may struggle to stick to their game plan for proper growth. The company's decision-making receives far more exposure and may be questioned by shareholders who don't agree with the C-suite's choices or the direction of the company. There are more people with opinions, which makes it difficult to be nimble as an enterprise.

Added Burdens for MSOs

The regulatory structure surrounding cannabis business investing is unique: It varies from state to state and down to the level of municipal government.

In certain states, the number of licenses a publicly traded company can hold might be limited. Up until 2018 in Colorado, publicly traded companies were prevented from holding licenses. While the law change heralded a wave of consolidation for cannabis businesses in Denver and beyond, there also has been pushback, such as the 2022 decision by the Steamboat Springs City Council to maintain its local residency requirement for cannabis business ownership in the mountain resort town.

Cannabis compliance and regulatory financial concerns are multiplied for publicly owned multistate operators (MSOs). Laws regarding everything from packaging language to cultivation security can change at a moment's notice. And state regulators are watching MSOs closely. For example, Nevada requires numerous applications to simply note things like changes in the boards of directors, quarterly physical inventory counts, temporary storage notices and point-of-contact changes. The entity structure in legal markets is multilayered and filled with fees at every level and application stage.

Operating in multiple states makes financial compliance overly burdensome, as it is challenging to keep up with all of the filings and threshold stock holdings that must be disclosed and approved. Similarly, regulatory violations have to be disclosed in reports. That increased visibility can be harmful to the brand and the reputation of the company.

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To prepare for the heavy lifting that comes after an IPO launch, companies should set aside resources for a dedicated employee (or department) to work solely on keeping up with cannabis tax obligations and ensuring the company remains compliant. Sometimes, it is all just too much, and company leaders who had dreams of going public decide in the end that it does not make sense to make the offering and opt to remain private.

There are plenty of pros and cons when it comes to going public in the cannabis sector—sorting out the risks and rewards comes down to making informed decisions that are right for your business goals.
