

ASX-listed technology companies well positioned in talent war, pending investor and proxy adviser support

October 5, 2018

Only a few years ago the idea that a venture capital (VC) backed start-up could reach an aggressive valuation of over \$1 billion (“unicorns”) without going public was inconceivable. But today unicorns are not unusual, with the *Wall Street Journal*, *Fortune Magazine*, and others publishing growing lists of such companies and their valuations. One unicorn even exists in Australia. However, while it has mainly Australian management, and most staff are in Sydney, it is incorporated in Delaware, and sucks in mainly US investors’ money, so perhaps does not count as “Australian”. The increased sightings of unicorns has coincided with a decline in the US market for initial public offerings (“IPOs”), caused in part by the availability of new private capital sources, which has led to US technology companies deferring public listing. Whereas, in the recent past, start-ups tended to go public or be sold approximately four years after founding, today the average time to IPO or sale for a US technology company is seven to eleven years.

In contrast, the volume of Australian IPOs is relatively high, in part explained by Australian private capital sources preferring to go into infrastructure, rather than technology. Australian technology companies tend to tap capital markets via a public listing earlier than their US, and to an extent, UK counterparts. And unlike their counterparts, they tend to be close to, or are, cash flow positive within a year or two of listing. This is reflected in their rapid rise in market value.

This augurs well for Australian technology companies in the war for talent. To ASX-listed technology companies it may not seem that way, in the feverish race to put backsides on seats (mind you, they are very smart backsides with rare technology skills attached).

Yet by staying private and not pursuing an IPO or sales transaction,

private technology companies are delaying liquidity events for their shareholders, including employees. To attract, engage and retain talent, technology companies must find ways to continue to offer employees equity (or a promise of equity) and facilitate liquidity opportunities. In this, private technology companies (especially the unicorns) are failing, whereas ASX-listed technology companies are winning.

ASX-listed technology companies can offer equity that has higher perceived value because it is more liquid. It has less risk too. Private companies tend to issue dilutive share options. Although there may be annual valuations, obtaining capital to exercise an option in a private company, and then finding a buyer for the shares within the valuation window, is too hard for most. Employees in technology companies need to convert equity to cash to acquire homes, start families, pay down mortgages, and all the other major expenses associated with the technology employee's typical lifecycle stage. They do not want to wait seven to 11 years. So an ASX-listed company that knocks on their door offering equity with liquidity has a clear advantage. In addition, the rapid growth and maturity curve of ASX listed technology companies sees a rapid transitions for share options as the vehicle of choice to share rights. A share right has tangible, transparent, and readily available value, and does not require the employee to find the capital for exercise.

Unicorn and other private technology companies are dealing with high turnover rates of knowledgeable employees, despite the fact that they generally offer their employees a competitive salary combined with high annual equity awards. In the past, many talented individuals chose to work for a start-up company, for a below-market cash salary combined with a substantial share option grant, and a dream of cashing out for a large sum of money after an initial public offering of the start-up's shares. Yet, today, due to "lock-in" and illiquidity of private technology company shares, employees are faced with a dilemma—if their options are expiring, then they must choose between forfeiting or exercising them. Many employees find that their options are prohibitively expensive to exercise due to liquidity constraints and tax concerns. That is, they find themselves in a worse cash position than before they exercised their options. There are also issues associated with narrow exercise periods on options

that are due to lapse if an employee resigns.

These issues are well known and understood in the technology company world. And so, therefore, is the attractiveness of ASX-listed technology companies, assuming of course, that they have a well-designed remuneration/equity framework. In that regard, alas, there are issues. The high valuations and success of ASX-listed technology companies may threaten to catapult them into the ASX 300. Pity. They then become subject to inflexible, ineffective, irrelevant and inapplicable proxy adviser and institutional investor remuneration guidelines. These guidelines were designed for stodgy, lower growth, higher yielding non-technology companies. Newly minted ASX 300 technology companies do not want to have equity grants vesting subject to long term financial or market measures that barely have relevance for a month, let alone three years, in a fast moving technology environment.

In summary, ASX-listed technology companies should be in a good place to compete globally for talent, if one ignores proxy adviser and larger institutional investor guidelines. So in the talent war, the main challenge for an ASX-listed technology company may not be attracting and retaining technical talent, but in configuring a board of independent directors with the skills and knowledge to navigate through external stakeholder guidelines and engage with key investors to ensure they have investor buy-in for a senior management remuneration framework that takes advantage of listed-ASX companies' liquidity superiority over private technology competitors .