Utilizing the Board for a Successful IPO

By Marie E. Kelly and Roger Kenny

Amid welcome indications that the 2010 initial public offering market is opening, if only for selective opportunities, the spotlight has turned to board directors, who have the potential to deliver significant value to companies that hope to navigate the still-risky path to a successful IPO.

Our experience at CTPartners Board Consultants has emphasized the importance of strategically effective board-building for companies with public offerings on their horizons. After all, IPO contenders face a highly competitive landscape: In contrast to 2009, when only 13 venture capital-backed or private-equity company deals managed to go public, the IPO pipeline was already crowded by early 2010, with more than 100 such prospects lined up within the first couple of months of the year. And clearly there are many more companies waiting in the wings, with plans to enter the market when and if liquidity conditions permit.

But "selective" is the operative word governing the current IPO market. Liquidity is still tight. With a plethora of growth-oriented companies dominating the pipeline, investors are scrutinizing IPO prospects more intently than ever, devoting a razor-sharp focus to the issue of "deliverability," most especially as this relates to a company's ability to deliver on its growth forecasts.

This is not too surprising, of course, since one of the key lessons learned during the recent global economic downturn was "don't go too soon." That is, don't take a company public unless and until it is prepared to deliver on its forecasts with consistent and transparent quarterly results.

During a recent NASDAQ conference, executives from several successful 2009 IPOs agreed that the biggest post-IPO challenge that they had faced was meeting regulatory requirements, especially those relating to quarterly financial reporting, proxy filings, and the like. The systems and processes that they had developed as private companies were stressed and even over-stressed by the requirements that they faced in the public arena, calling for a greater sophistication.

Within a regulatory climate that is becoming ever more intense, private companies are ill-advised to attempt IPOs before they can demonstrate to prospective investors that they have the people, systems, and processes in place to successfully handle this transition. Here a well-designed board of directors with operating experience can make a significant difference.

Why the Board Matters

In our present highly selective initial public offering marketplace, the right board has the potential to be a key asset with which to effectively differentiate one company from the rest of the pack. Here the emphasis should be on solid versus well-named executives.

Yet, ironically enough, board-building strategies have tended to be overlooked in the race to go public. Another common mistake: Companies have failed to appreciate that whatever board strategy worked well for them while functioning as a private venture probably will no longer best apply as they prepare themselves to compete in the IPO arena – and afterwards, to meet the tough demands placed on public companies.

Let's start with one basic reality, IPO investors will expect to see directors on the board whose backgrounds, skills, and experiences are aligned with the markets and customers that are essential to the company's growth. This makes such good sense that it is hard to believe it ever fails to happen. After all, well-aligned independent directors can help management assess risks tied to the growth strategy, capitalize on relevant opportunities, and, quite simply, open the right doors and lift the company's sights.

For prospective investors, it sends a powerful message about an IPO candidate's ability to deliver on its growth prospects when directors like these are on a board. Likewise, it also sends a powerful message when the board lacks such directors.

It's worth emphasizing that the most valuable independent board director for a company at this stage is not necessarily a CEO with a "marquee" name. That's another common misconception. In fact, the best directors usually are successful individuals who thrive on the challenges intrinsic to growing a company from one milestone level to the next. In terms of their own personal interests, they seek opportunities in which they can have a major impact in helping a growing company mature and succeed. They're the types of business leaders who want to be involved in strategy and operations. And, as prospective investors will recognize, they possess the experience and qualifications to help make this happen.

As an important element in building the right board of directors, it makes sense to include a public company CFO or a CEO who has taken a company public. That's always been the case, but it's especially important given

today's intense focus on how ready any IPO contender may be to deliver on expectations in terms of top-line growth projections and bottom-line financial performance. Independent directors who truly understand the disciplines governing public companies will be prepared to stress-test a company's business plans, systems, and procedures, while digging into the realities and risks involved with current and projected activities.

The presence of independent directors with expertise in operations also may play an important role in helping a company avoid the risk of going to market too soon. Their perspective is different from that of investor partners, who will be focused on the financial side and who will rightly have their own strong influence on the company's direction and activities. Yet it is the independent directors, drawing upon their operational backgrounds, who may best be able to forge together the founder's vision with the investor partners' financial goals, developing one cohesive business strategy. These independent voices are essential in helping boards determine that the company has the strategies, systems, track record, vision, and window of opportunity to successfully enter the public marketplace.

The "Model" IPO Board

If timing is indeed everything, today's IPO contenders must prepare for likely upcoming regulatory changes that will place more focus than ever on the roles and composition of public company boards.

This is a profound reality that simply cannot be ignored, either by public companies or those companies that hope to go public. New SEC proxy rules will require enhanced disclosure about matters such as individual director qualifications, the board's role relating to executive compensation and risk management, board leadership, and diversity policy.

Within this challenging and ever-changing environment, IPO contenders should expect prospective investors to

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closely scrutinize whether their boards are, effectively, "ready for primetime" in the public arena, or not. Do they possess the functional and strategic expertise to be capable of providing leadership? That's especially important when it comes to the key committees that should offer the sound oversight and governance necessary to protect shareholder interests.

There is no single blueprint for a "model" IPO board, since boards, like the companies they serve, are and should be unique. The right board will differ, depending upon the strategic goals, market position, risk profile, and culture of the company. The best mix of directors on a pre-IPO board should, however, include:

- The company's CEO or former CEO
- Independent directors with operating experience in the markets, customers, technologies, and functions that are strategically important for the company's success. Ideally, there should be two or three such directors on the board, since one will be needed to chair the Nominating and Governance Committee, while the presence of others should help ensure a majority of independent directors.
- A public company CFO should serve as Chair of the Audit Committee, providing experienced guidance to help meet public company reporting and regulatory requirements.
- A director with operating and talent development experience should chair the Compensation Committee.
- Representation from the current investor partners, whether venture or private equity, also can be helpful in providing deep industry knowledge, financial value focus, and continuity on the board.
- Additionally, if the current CEO is inexperienced in the public arena, as may often be the case with growth company IPOs, it can be invaluable to add a seasoned former CEO to the board as independent chair, to serve as a mentor to the management team.

Obviously, successful board-building requires care and attention. The rigors of the current IPO market and regulatory climate make it essential for companies to create a "winning" public company board while they are still in the pre-IPO stage. This isn't easy, of course.

We believe the right board signals a key strategic asset that helps ensure the likelihood of a successful IPO. Little wonder that board-building is such an important element in the overall effort to prepare a private company to deliver, post-IPO, on its financial projections. Ultimately, there may be no better way than effective board-building to clearly demonstrate to potential shareholders that their interests have been well considered.

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