

Building the ideal pre-IPO board

Assembling the right team from scratch brings competitive advantage.

BY LEE HANSON AND TED JADICK

THE INITIAL public offering market is bouncing back as global economies recover. In 2010 U.S. IPO volumes soared to over 150, raising over \$35 billion. This volume represents an increase in both volume and valuation from 2009 and 2008 numbers. This increase was led by financial sponsor-backed offerings as well as an influx in international participation. And 2011 is off to a strong start in the IPO market, but only time will tell if the market-impacting events from around the globe will slow the pace of filings here in the U.S.

Preparing for an IPO, companies and their investors must build a number of new capabilities in order to maximize shareholder value and meet market expectations. But for a company approaching the public markets, thoughtful board selection is perhaps the smartest move they can make.

The opportunity to build a board *de novo* is a competitive advantage for a pre-IPO company because it adds essential skill sets to a budding company. Tapping the right team at the start builds confidence among staff, stakeholders, and investors. A strong board arms a company for the heightened scrutiny public companies face.

Pressure is also rising to comply with recent SEC rules on board compensation, diversity, and conflict-of-interest issues. Specifically, the rules stipulate that prior to their appointment, new directors should have no direct or indirect

ties to a company that imply a conflict of interest, and that great effort be taken to achieve a balance of gender, race, and industry experience on a board.

The SEC, and many global exchanges, require that at least one audit committee member be considered a qualified financial expert. Boards are also mandated by some exchanges to have independent audit, nominating/corporate governance, and compensation committees.

A strong board arms a company for heightened public scrutiny.

Today's companies — particularly those backed by private equity — are seeking significant audit, legal, regulatory, or CFO experience in their new board members.

Adding members to any board can be a difficult undertaking, but building a board in a pre-IPO situation can be daunting for any company. The pressure to get the initial board members in place quickly to satisfy initial filings, while mapping out what the entire board will look like, can impact how a company is viewed in the marketplace.

The skills mosaic

While the skill sets needed by most pre-IPO boards are the same as those we typically look for in established boards — financial skills, international skills,

operating skills, audit and diversity — there are special needs as well. Typically when we do a board search, we are looking to fill one, two, or even three spots in an established board culture. Building a new board allows us the opportunity to assist in building a new culture, and piece together a mosaic of skills and personalities that work to further the company's strategy and best maximize shareholder value. The selection of the initial three placements is therefore critical and oftentimes requires an accelerated timeframe.

In the case of a pre-IPO board, often while the CEO has been identified, he or she may not have previously served in a CEO role. Therefore, a premium is put on recruiting directors who have previous board experience and who understand how public companies work. The situation becomes more challenging when there are other investor interests involved. Getting all parties on the same page and in agreement with what the right skill sets look like and what the overall culture will be can have a huge impact on the selection process.

Heidrick & Struggles uses a matrix method to map out the skill sets needed to fit the company's strategic direction and regulatory needs for all clients. The unique situation for an IPO client is to also set the tone and stature of the board. Those who are recruited for a board want to know who else is on the board. "Do I feel I'm going to be a peer of those directors? Is the board a group I want to be associated with?" they ask.

And, if the lynchpin directors are of a sufficient stature, those newly recruited will say, “Impressive: you got ‘so and so’ to join that board. That’s one that I should look at too.”

The corporation is a living entity, and it changes, along with industry dynamics. So a new board begins with a balanced blend of financial, operational, international, legal, and industry experience among directors. Then, as its needs expand and evolve, directors retire, or industry-wide needs arise, these new gaps continue to be filled in.

Unique challenges

Pre-IPO companies (be they private equity or venture-backed, spinoffs, or post-bankruptcy), face one unique challenge when building their boards: a highly compressed timeline.

The pre-IPO company lacks the luxury of time. Often, it must fill between five and nine slots with a range of knowledge and experience in just months versus years. It must find the appropriate skills while building a company culture and board dynamics — quickly — that meld well with new management. Moreover, how a new board is assembled varies based on whether the looming public entity is a spinoff, a private equity-backed venture, or is emerging from bankruptcy. *Who* decides also depends on the structure of the pre-IPO company.

• **The Private Equity or Venture-Backed Company:** Often the PE firm initially retains a role in future company governance and ownership. Both at that point, and when the investors exit totally, prospective shareholders look for a public company board with high-stature financial experts who will ask and act on the tough questions.

We get involved in both pre- and post-IPO situations where PE firms are leading voices in the process. Our guidance is sought to protect the shareholder

interests and to ensure that SEC regulations are met.

• **The Spinoff:** Public companies spin off businesses they believe are worth more apart than together, so that investors can more easily recognize and assign appropriate value to the companies. Often the parent company identifies the new company CEO and at least one or two directors.



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In one example of a spinoff company with which we worked, we were called in by the parent company and told, “We have a company that is a top player in its business, and we have decided to spin it off. The CEO has never been a public company CEO before, but within three months he’s going to be the CEO of a publicly listed company. We would like you to talk to him about what skill sets he will need, and then go find those skill sets and build a new board.”

The first step was to find a chair of the audit committee, which is a critical step to meet regulatory needs. Next, we created a matrix of the skill sets needed to support the new CEO and board in the current environment, and then began to systematically recruit the rest of the board. It is all about finding skills that will line up with the new company, its strategy and vision, and address its needs domestically and internationally. Heidrick & Struggles has worked hard

over the years to not only serve as a recruiter for our clients but to also lend counsel to our clients on governance standards and any upcoming legislation that might impact the choices they are making today.

• **The Post-Bankruptcy Company:** A reorganized company often has more players involved with building its new board, including creditor committees and bankruptcy lawyers. Placing financial experts such as a retired CFO, audit partner, or a C.P.A. on the board can assure a smooth transition into the public markets and thus do much to appease institutional investors.

In one case, when a restructured company needed to rebuild its entire board, we were called in by the newly recruited CEO to sit down with the creditor committee, discuss the entire process, and then agree that we would be the ultimate arbiter to choose new directors from a candidate pool of 29 individuals. Within a few short months, the CEO and new board rang the bell on the stock exchange with nine new directors in place on the day the company emerged from bankruptcy.

Right at the start

Building a board at any point is not easy, particularly under a more demanding SEC, investor, and regulatory environment. But building a pre-IPO board is an excellent opportunity to get it right immediately and for the future — further enhancing shareholder value. By taking the time to map out and recruit for the perfect mix of skills and personalities, management can create the perfect alchemy. As many successful CEOs report, it is the most cost-effective advisory resource you can have when going through the process of an initial public offering. ■

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