



## BUILDING A FIRST-CLASS BOARD OF DIRECTORS PRE-IPO

- The composition of a corporate board is critical to the health and effectiveness of every listed company. The ideal board comprises a diverse group of directors from widely varying backgrounds who bring complementary skills and work well as a team. Companies planning an initial public offering have a unique opportunity to shape the board composition to reflect the direction, challenges and opportunities of the business and to send an important signal to the market about the strength of the company's governance and leadership.

As they move toward a public offering, portfolio companies must evolve their mostly insider board — typically, the CEO and representatives of the private equity sponsor — to a board of directors primarily composed of independent directors. The stock exchanges require boards to have a majority of independent directors within one year of listing. In addition, post-IPO, the company must have an audit committee that meets SEC and stock exchange rules on composition, independence and financial expertise, and within one year the audit, compensation and nominating committees must all be fully independent.\*

Executives who have been through an IPO recommend starting early when building the board; it can take longer than most people assume to find and recruit the right team of non-executive directors. Here are several recommendations and considerations for companies and sponsors thinking about board composition in preparation for an IPO.

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\* The NYSE allows an exception to this requirement for controlled companies. Listed companies also may redirect the responsibilities of the compensation committee to another committee of independent directors.

## Think holistically about board composition

Building a new board should start with a thoughtful, detailed process designed to identify the talents, backgrounds and knowledge that will be needed on the board to evaluate and propel the strategy, manage risk effectively and respond to compliance requirements. The CEO and investors should take a holistic approach by mapping out the ideal board composition rather than pursuing one-off recruitments. This process should take into consideration independence requirements, the need for public company experience, the strategic direction of the business, committee needs — particularly for audit committee financial experts — and other areas of expertise that could be valuable in the boardroom, such as digital or international business experience. If investor representatives are to remain on the board once the company is public, evaluate whether they qualify as independent directors based on their relationship with the private equity firm. Finally, develop a migration plan to roll off lead investors and add qualified non-executive directors.

When creating a new board, it is generally better to start small, both in terms of the number of directors and the number of committees. Ideally, the board should be small enough to have high-quality, active discussions and large enough to populate the committees. Over time, gaps in the board's skills and committee needs will become evident, and needed additions or changes can be made. A good place to start is with a core group of seven to nine directors and with the three mandated committees.

## Identify board leaders early

Secure directors for board leadership roles first, especially the non-executive chairman or lead director. Recruiting a strong, independent leader for the board who has both public company board experience and credibility with investors can be a huge asset in building out the board. Indeed, this individual may be charged with helping to sell the opportunity to other director candidates. The process begins by determining all the characteristics the company will need in the board and the CEO in order of priority, and then evaluating which of those traits the CEO brings and which would be valuable in the non-executive chair or lead director.

## Plan for committee needs

A key aspect of developing the right mix of skills on the board is populating committees with appropriate technical expertise. Knowledgeable, independent directors are needed to lead and serve as members of the audit, compensation, and nominating and governance committees. Committee chairs, especially, must be current on the relevant governance issues and trends.

The audit committee chair should have financial expertise and public company board experience, as well as the time to devote to the role. Retired CEOs, chief operating officers and chairmen are a growing source of audit committee chairs, as are active and retired finance executives. A compensation chair might be a current or former public company CEO or someone who has previously served as a compensation committee chair and is up to date on compensation issues and trends and can lead the board in creating an appropriate and defensible compensation model. The nominating committee chair should be experienced in board governance and have a thorough understanding of best practices and evolving trends in corporate governance.

## Board-building checklist: Develop a skills matrix

- Think holistically about director recruitment as opposed to one-off recruitments.
- Develop a matrix of the overall skills and experience required for the board.
- Use the skills matrix to ensure the bases are covered when recruiting.
- Think about the various diversity dimensions that would be valuable to include on the new board, including geographic representation.
- Determine the qualities and experience most critical in a lead director or non-executive chair for your new board.
- Outline specific requirements for key committee chairs.
- Consider specific constituencies that will be important to the board and recruit directors who are familiar with them.

## Ensure diversity on the board

Another important consideration when building a board is diversity. When directors with diverse backgrounds and experiences are sitting around the board table, board deliberations benefit from an expanded set of views on issues, options and solutions. Diversity takes many forms — such as age, gender, race and ethnicity and, in some cases, geographic knowledge — and the relevant mix of perspectives sought by a board will vary depending on factors such as the scale of the business and demographic considerations (e.g., customer base and geographic footprint). Adding international directors to the board can be a sensible step if the company has made a strategic decision to extend its global footprint, build manufacturing and distribution capabilities overseas or move into a particularly competitive or complex market.

## Establish a foundation for effective governance

Determining the appropriate governance structure and building a cohesive board culture are vitally important. The governance structure for the new board can have an impact on director recruitment, board size, committee makeup, the frequency and location of board and committee meetings and director compensation. Among the issues to be considered are the structure of the chair and CEO roles, committee charters, public company policies and fiduciary responsibilities. It also is important to define the desired board culture and the personal characteristics directors will need to possess to build that culture. Look for directors who are able to question, discuss, listen, express an opinion and articulate differences in a constructive way. The best directors are willing to make the tough decisions and be accountable, while being a team player.

Many new boards find it invaluable to have an orientation on important business issues or governance topics before the first formal board meeting, when they must deal with actual board issues. Convening directors informally for training and social gatherings helps the board to get off to a fast start once their formal responsibilities begin.

## Board-building checklist: Organization and process

- Determine governance parameters for the new board and the potential impact on director recruitment: board size, committees, the frequency and location of board and committee meetings, and director compensation.
- Consider building upon the policies of the current board or peer companies.
- Assemble the principles to use in director recruitment.

## Board-building checklist: Pay attention to board dynamics

- Define the desired board culture and personal director traits to ensure congruency.
- Plan kick-off events for new directors, including social dinners and a board orientation, that will model and reinforce the culture.
- Plan ongoing training and information sessions with the board to ensure all directors receive the company knowledge they need to effectively carry out their duties as board members.

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## Conclusion

An IPO is a massive and challenging undertaking, requiring a company to create new systems, identify and address talent gaps, manage the regulatory reviews and build credibility with analysts and investors, all while running the business at a high level. A strong, high-performing board can be a valuable asset in guiding management through the IPO process and preparing for life as a public company. Wise boards will continuously review their skill-sets and performance relative to the company's strategy and direction to ensure that they have the knowledge, experience and skills needed for the future.

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