Going public?
Five governance factors to focus on
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**PwC’s Center for Board Governance**

Our Center for Board Governance helps corporate directors effectively meet the challenges of their critical roles. We do this by sharing governance leading practices, publishing thought leadership materials, and offering forums on current issues. We also meet with boards of directors, audit committees, and executives to share our insights into significant corporate governance challenges and developments.

Find more information at [www.pwc.com/us/CenterforBoardGovernance](http://www.pwc.com/us/CenterforBoardGovernance)

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We bring experience in a broad range of functional areas to help management anticipate business risks and develop programs to manage such risks early in the IPO planning. Our teams work with companies to provide guidance through the complex life cycle of a capital market transaction—from helping to determine the right entry strategy and assessing IPO readiness, to assisting with the public registration process, to preparing for ongoing obligations as a new public company.

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**About this publication**

This publication highlights five key governance considerations you’ll want to keep in mind as you contemplate a public offering. It summarizes key messages from its companion document, *Governance for Companies Going Public—What Works Best™*. That publication includes information on governance requirements from the Securities and Exchange Commission and the stock exchanges, describes in more detail key governance choices that companies have, and gives an overview of the governance landscape, including the issues shareholders are focusing on. It also provides questions for executives and directors to consider as you navigate this transformation.

To have a deeper conversation about corporate governance for companies going public or other items to consider as you contemplate a public offering, reach out to one of our professionals listed at the back of this publication.
A company that is planning to go public has a lot on its plate. Ensuring corporate performance doesn’t lag and make the company look less attractive to potential investors. Addressing financial reporting and auditing considerations. Dealing with concerns from regulators. The result? Governance decisions rarely get the focus they should. But the many governance rules and requirements for boards, along with what anticipated shareholders will likely expect, mean these decisions merit at least some early attention and consideration.

Establishing governance practices is always a balancing act. While executives may welcome the valued advice that seasoned directors can bring, they are also sensitive to whether implementing certain governance practices too early will divert their attention and resources away from running the company.

This publication highlights key governance decisions and issues for companies going public. So whether you are an executive who at the end of the day needs to make things happen or a director considering joining the board of a pre-IPO company, this publication is a good place to start.

It groups the key IPO governance factors into five categories:

1. Understand the basic governance requirements that will apply to you.
2. Consider what changes you need to make to your board composition.
3. Understand the potential shareholder mix you’ll have and the role of others who influence governance at public companies.
4. Understand your key governance choices and the implications of those choices.
5. Get resources and support to put your needed governance processes into place.
The companion book to this publication, *Governance for Companies Going Public—What Works Best™*, more fully describes the many rules and regulations that apply to public company governance. It also explains the various terms (for example, what majority voting means) and the implications of governance decisions. You can download a copy from www.pwc.com/us/centerforboardgovernance/publications.jhtml
1. Understand the basic governance requirements that will apply to you

Public companies are subject to many requirements that impact their board composition and governance practices, as well as the structure, composition, and responsibilities of their board committees. So it’s important to start by understanding what basic rules will apply to your company when it goes public.

First off, the SEC has a number of rules on governance. For example, specific requirements for audit committees and compensation committees⁴ address committee independence, authority, and selected responsibilities. The SEC also requires a number of specific proxy disclosures on governance issues—describing how the board oversees risk, establishes board leadership, and considers its diversity, as well as information on board committees and the number of board and committee meetings.

Additionally, the SEC requires companies to provide detailed proxy disclosures about each director. These include: age; whether a director is independent; which specific skills and experience he or she brings to the board; which other public company boards he or she serves or has served on during the previous five years; certain legal proceedings a director is involved with; and the amount and makeup of the compensation each earns as a director at the company. Plus, the company will have to name in the proxy at least one director who the board determines is an “audit committee financial expert,” under the SEC’s definition.

For their part, the New York Stock Exchange and the NASDAQ Stock Market both establish governance requirements for their listed companies. Both require that a majority of directors on a company’s board be independent. Both also require all directors on audit and compensation committees to be independent. And both provide exemptions to these rules for controlled companies—where an individual, a group, or another company holds more than 50% of the power to elect directors.

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⁴ The rules for compensation committees are in transition during 2013 and 2014, impacting committee member independence criteria and responsibilities. Please refer to the actual stock exchange and SEC rules for specific timing and requirements.
Other governance requirements differ based on whether you choose to list on the NYSE or the NASDAQ. Some of those differences—such as the definitions of what constitutes an “independent” director—are subtle. But other differences are more substantial, such as the additional responsibilities the NYSE requires of audit committees. For example, audit committees at NYSE-listed companies have to oversee compliance with laws and regulations, discuss company risk assessment and risk management policies, and discuss the earnings press releases and other financial information and earnings guidance provided to analysts and rating agencies.

The NYSE requires boards to have audit, compensation, and nominating/governance committees. It also requires these three committees and the full board to assess their performance every year.

NASDAQ has relatively fewer requirements. It requires boards to have audit and compensation committees, but doesn’t require a separate committee to handle director nominations, as long as the independent directors on the board are involved.

Although the NYSE and NASDAQ impose different requirements for audit committee responsibilities, in our experience many audit committees at larger NASDAQ companies voluntarily adopt and include in their charters many of the “extra” NYSE requirements.

Both the NYSE and NASDAQ allow new public companies a transition period before they have to comply with the board and committee independence requirements. That said, many companies fully adopt the board and committee independence requirements by the time their final registration statement goes into effect, perhaps spurred by a desire to demonstrate their commitment to governance.

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**Average percentage of independent directors on the board**

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<thead>
<tr>
<th></th>
<th>Noncontrolled companies</th>
<th>Controlled companies</th>
<th>All companies</th>
</tr>
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<tbody>
<tr>
<td>At filing of the final S-1</td>
<td>70%</td>
<td>35%</td>
<td>56%</td>
</tr>
<tr>
<td>As of the most recent proxy</td>
<td>75%</td>
<td>49%</td>
<td>68%</td>
</tr>
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</table>

Source: PwC IPO study
There are so many rules around board composition and duties that it’s easy to lose sight of a board’s overarching purposes. While boards have to oversee management and the company, high-performing boards also add value by providing management with thoughtful and sage advice. Ideally, boards help management teams ultimately get to a better answer on company strategy and related major decisions, resulting in improved company performance.

As you think about the transition to becoming a public company, along with the growth and evolution that process involves, it’s helpful to consider whether additional skills, experience, or diversity on your board would help. While a private company may already have excellent directors, if those directors aren’t independent, they won’t be eligible to serve on the key committees and their long-term service on your board may be limited. And so you may need to transform your board to meet independence requirements described in the earlier section.

A PwC analysis of companies that went public from 2010 through 2012 shows roughly two-thirds had a financial sponsor—typically private equity or venture capital firms. Often such firms place their own executives or individuals affiliated with their firms on their portfolio company boards. If the PE or VC firm’s exit strategy for a portfolio company includes a potential IPO, those directors may not be considered independent, which restricts, for example, their ability to serve on the audit committee beyond a year after registration. Post-IPO, PE and VC firms may have a schedule to relinquish board seats as their ownership percentage diminishes. Accordingly, you will need to take any such planned director resignations into account as you consider how your board’s composition will evolve.

Once your company is public, your directors are going to get a certain level of scrutiny. Your shareholders will be assessing board composition, perhaps not when deciding to buy at the initial offering, but at some point. And starting with your first annual meeting of shareholders after going public, they will get a vote on electing directors. Certain major institutional investors have become more vocal about board composition for new companies. They express concerns about any directors they believe are “overboarded”—that is, sitting on numerous boards—and if the board doesn’t appear to be sufficiently diverse.
Our discussion on board composition so far has been about skills, experience, and independence. It’s also important that potential new directors will fit in and be able to work effectively with other directors and management. Experienced directors recognize how important board dynamics are to the board’s ability to be effective, and they pay a great deal of attention to this issue.

Practically, how do you find new directors? The most common way is to look to current directors’ networks, respondents in PwC’s 2012 Annual Corporate Directors Survey said. And two-thirds of directors said their boards use search firms. But whatever your source for potential directors, you will want to have full background checks on your candidates, so you have confidence that what you disclose about them in the registration statement and in subsequent proxies is complete and accurate.

Finally, finding new directors for your board can take more time than you would expect. Some directors are concerned about liability involved in signing the registration statement if they join your board before you sell shares to the public. Accordingly, they may defer joining until after the IPO is completed.

Regardless of when you’re looking to add directors, candidates will want to understand what indemnification your company provides, what protections are afforded them by limitations of liability in the company’s certificate of incorporation, and the scope of the directors and officers (D&O) insurance you provide. Candidates will also weigh the director compensation they will receive with the anticipated time commitment and the level of risk they expect.

It’s important to recognize that your work doesn’t end with identifying and recruiting new directors. They need to receive orientation to your company, and perhaps to the issues and competitive landscape in your industry if they lack that experience. Key executives should expect to spend some time with new directors, discussing the company and operations. And existing directors should also plan to meet with and support new directors. A robust orientation program will help new directors add value in the boardroom sooner.
When you’re planning to go public, there is an understandable tendency to focus on the initial sale of shares to the public: how the underwriter will market your offering, how many shares you should sell, and how you should price your shares. And so you devote a lot of attention to attracting initial buyers. Companies often find that the investors who buy at the IPO may not hold the shares for the long term. Accordingly, once initial IPO investors have disposed of their shares, you may find your company has a different mix of investors and faces a challenge to understand what they expect from a governance perspective.

One thing is certain: Your shareholder base won’t be homogeneous. Different shareholders have different investment horizons and objectives; this can prove challenging not only from their expectations for your company’s performance, but also because they may bring conflicting perspectives on how you should structure your board and the governance practices you should adopt.

It’s helpful to understand which institutional investors you might have and what their expectations are for governance. Large institutional investors often provide policy statements that outline their preferences and views on governance structures. The statements also give some indication of how they are likely to vote on routine matters, such as director elections and executive compensation, and on governance proposals, such as splitting the CEO and board chair roles or changing director terms from three years to one year (also known as declassifying a board).

Many companies find it helpful to establish a program to connect with shareholders periodically. One way is through an investor relations function, which we describe in the section on resources.

“IPO companies put too much emphasis on marketing their stock to short-term investors and don’t spend enough time thinking about the governance structures that make sense long term, both for investors and for the company.”
—Investor
But a public company’s need for outreach and connection doesn’t end with investors. Proxy advisory firms such as Institutional Shareholder Services (ISS) and Glass Lewis play a central role in proxy season voting. They analyze company proxies and make recommendations on how institutional investors (who subscribe to their services) should vote.

It’s easy to understand why they have influence. An institutional investor, who may hold shares in thousands of companies, simply doesn’t have the resources to analyze all of the complex proxies during the relatively short proxy season. So institutional investors may use proxy firm voting recommendations for the majority of the voting decisions, which allows them to devote their attention to a subset of companies, for example those with poor company performance or those proposing a major transaction, such as a merger.

So, practically, how might you deal with this group of influencers? First, review their voting policies and compare them to your practices. If you find any that conflict, that doesn’t mean you’ll necessarily change your practices if they are right for your company’s facts and circumstances. But it will at least alert you to a potential issue. And it may prompt you to consider expanding your proxy disclosures to more fully explain the reasoning behind your choices.

The proxy advisory firms provide copies of their reports to the public companies whose proxies they analyze. After you’re public, you should review the reports and ensure the information they captured is accurate. Finally, if a dispute arises or they are recommending a vote against what the company recommends, you can reach out to discuss the matter with them. You’ll also need to reach out to your key shareholders, as described in the section on resources.

In PwC’s 2012 Annual Corporate Directors Survey, 31% of directors said they believe proxy advisory firms influence more than 30% of the vote.
Recognize that while there are certain governance requirements, companies have a great deal of discretion on many governance decisions. What types of decisions do we mean? Whether to combine or split board chair and CEO roles. Whether to elect all directors every year or only a portion of the board every year (a key antitakeover defense). Whether to set any term or age limits for your directors. Whether to have majority or plurality voting. You should understand these and other governance choices you have, and their implications.

**Governance decisions data**

<table>
<thead>
<tr>
<th>Combined chair and CEO</th>
<th>Classified/declassified board</th>
<th>Director age limit</th>
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<tbody>
<tr>
<td>No</td>
<td>Yes 42%</td>
<td>No 100%</td>
</tr>
<tr>
<td>NA 6%</td>
<td>NA 2%</td>
<td>Yes 0%</td>
</tr>
<tr>
<td>Declassified 34%</td>
<td>Classified 84%</td>
<td></td>
</tr>
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Source: PwC IPO study, based on filings of final S-1s. NA - not available

When deciding on what approach to take, your primary consideration should be what works for your company’s facts and circumstances. But it’s also helpful to have your decisions informed by understanding how your potential shareholders will view the decisions. Be aware that some issues, such as whether you elect all directors every year or not, are particularly sensitive for shareholders. Investors’ policy statements, discussed in the earlier section, are a good guide to how they make voting decisions on such issues.

4. **Understand your key governance choices and the implications of those choices**
And that brings up another point: When investors are concerned about a company’s governance practices, they may submit a shareholder proposal to be included in the proxy for vote by all shareholders. In recent years, the majority of shareholders voted “for” two of the most common proposals—to declassify boards and to adopt majority voting. Although these votes are advisory—that is, they don’t bind a board to act in accordance with the vote results—ISS’s voting policy recommends withholding votes against directors who ignore such majority results in shareholder proposals. (This ISS policy takes effect in phases over the 2014 and 2015 proxy seasons.)

Another aspect of shareholder voting has implications for companies. On a number of items, including director elections and the say on pay votes, brokers can no longer vote proxies unless they have specific instructions from the shareholders on whose behalf they hold shares. Thus, one historical source of likely support for the company’s proposals no longer exists. That means public companies may need to think differently about reaching out to shareholders, especially retail shareholders, to encourage them to vote.

“There are a lot of decisions that need to get made on the governance structure. Too often, they are too rushed and brought up too late in the process.”

— Director
5. Get resources and support to put your needed governance processes into place

We have described a number of key decisions and processes to consider as you go public. But they don’t magically occur. You’ll have to determine which resources you need to support the board and the company’s governance processes. If you are a smaller, resource-constrained company, initially it may make more sense to contract out for some of this assistance. As the company matures and grows, bringing the skills in house may make sense.

You’ll likely need support with governing documents, including committee charters. Charters need to comply with the basic requirements from the SEC and your listing exchange, and also reflect what your committee is doing. Legal counsel is usually involved in developing the charters. Since charters generally are posted on company websites, they will attract scrutiny. We recommend that you document only the additional discretionary processes you are already doing, not leading practices you think you should adopt but haven’t yet put into place.

Many individuals who are active on boards or advising boards also caution against using other companies’ charters and just changing the company name.

Your board will also need support with the blocking and tackling of governance: scheduling board and committee meetings and preparing meeting agendas and minutes. This is important work and should reflect careful consideration. For example, if a board is ever challenged in court, the agendas, meeting materials, and minutes provide crucial insight into the information directors considered and whether they had a deliberate process that shows they discharged their fiduciary duties. Accordingly, it is worth discussing with counsel the level of detail that should be captured in the minutes, in an effort to strike the balance between bare bones and minutes resembling a transcript.

Often the resources discussed above involve legal counsel to support the company and the board. Your audit and compensation committees also need to decide which external auditors and compensation consultants, respectively, will best meet their needs.

“Be careful when using other companies’ charters to develop your own. They might not represent how your committees function.” — Director
Auditors. If a company uses a small local or regional accounting firm, its underwriters may suggest it consider retaining a larger firm, to add credibility in the offering process. Additionally, if a company is expanding into new markets or countries or making use of more complex types of transactions, it may also find it needs to select an audit firm that brings a broader scope of technical expertise and resources.

Compensation consultants. Your compensation committee has the authority to engage compensation consultants or similar advisors. That said, the SEC requires compensation committees to consider a number of independence factors before retaining such consultants. This focus on the role of compensation consultants and the objectivity of their advice is part of the concern many investors have about compensation levels and the link between compensation and risk taking.

You should also be aware that your board is likely authorized (or should be, if it isn’t already) to hire whatever legal or other advisors it considers necessary and to have the company pay the fees. That may be especially useful if you need to have an investigation conducted or seek advice if you receive an unsolicited tender offer.

Once your company is public, you will also need to address investor relations. Whether your company is large enough to warrant a separate function, or you outsource it or simply roll the duties under another company function, you will need some deliberate and coordinated way to build relationships with shareholders and be able to understand their concerns and views.

It’s also helpful to understand the types of support available from other organizations, such as proxy solicitation firms. Among other services, such firms help public companies track and try to influence shareholder voting. If at some point in your life as a public company you find you are facing a close vote on an issue, you may wish to engage such services.
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