Governance for Companies Going Public
What Works Best™
About PwC

PwC’s Center for Board Governance

Our Center for Board Governance helps 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.

This report was created as part of our commitment to providing directors with leading practice guidance for being effective in the boardroom. It is one of our “What Works Best™” series, which includes publications listed in the back of this book.

Find more information at www.pwc.com/us/CenterforBoardGovernance

Download our iPad app from here: www.pwc.com/us/BoardCenterApp

PwC’s IPO team

Whether your company is an emerging business seeking venture capital, or an established company seeking to expand through an initial public offering, we can help you with our capital markets services professionals, plus the power of PwC’s advisory and tax capabilities.

We bring experience in a broad range of functional areas to help management anticipate business risks and develop programs for managing such risks early in the IPO planning process. 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.

Find more information at www.pwc.com/us/ipo or reach out to one of our partners listed at the back of this publication.
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Introduction
Companies that want to go public often find the process is more complex and takes longer than they anticipated.

When planning an initial public offering (IPO), one essential element to keep in mind is the governance policies and practices you'll need. There are some substantial public company governance requirements and expectations. At a minimum, you will have new shareholders with diverse or sometimes conflicting expectations for the company’s and the board’s practices.

This publication is a guide to help both directors and executives of companies planning an IPO think through the many governance decisions needed. It creates context for the IPO and the directors' roles (Chapter 1) and covers building the board (Chapter 2), understanding the myriad governance influences (Chapter 3), providing proper protection for directors (Chapter 4), and preparing for your first year as a public company (Chapter 5).

As well as describing the issues, each section has helpful questions to consider as you navigate this critical time in your company’s transformation. The publication also includes appendices that more fully describe certain governance requirements, such as board-related proxy disclosures and committee responsibilities.

Because we recognize there is no “one size fits all” solution to governance, our publication provides benchmarking information on the governance structures adopted by companies of different sizes. It also offers insights from PwC research on the evolution of governance structures pre- and post-IPO, as well as insights from directors, executives, and advisors who have been on the ground during the transformation.

As your company either contemplates or makes its way through the IPO process, we hope this publication serves as a useful guide, both “Going Public” and “Being Public.”

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**Interview insights**

Small companies pay little attention to governance. It’s not even on their radar.

—Director

**Interview insights**

Before joining a board of the company that wants to IPO, I would question if they have a hope of going, staying, and being successful as a public company. Not every company survives.

—Director

**Interview insights**

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

**Interview insights**

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
Going public—understanding IPOs and directors’ roles
Going public—the process of taking a company through a public offering—encompasses a number of elements, from gathering necessary financial and other information to determining the appropriate legal and tax structures, filing with the SEC, and marketing the shares.

While taking a company public is exciting, it can also be challenging. Directors who have experience with companies that have been through the process can provide valuable advice and support to management. As can directors who understand what it means to operate as a public company.

Going public changed for some companies in 2012, as passage of the US JOBS Act introduced new options—including the ability to file as an “emerging growth company.”

At the same time a company is preparing to go public, it must also transform the organization into one prepared to be public. Subsequent chapters in this book address the governance aspects of that transformation.

### 1.1 Origins of IPOs

US IPOs generally originate in three ways: from financial sponsor-backed companies, from company spin-offs, or from more traditional founder/privately owned companies.

**Financial sponsor-backed companies:** These companies have been funded by active, professional investors, including private equity firms, venture capital firms, and possibly others. These investors typically have a time horizon for exiting the investment, and they usually want to keep their exit options open. They want the flexibility to select the most advantageous exit timing and approach. So they may prepare a portfolio company to go public at the same time they’re trying to sell it to another company or investor. If a portfolio company does go public, over time these investors typically reduce or totally eliminate both their ownership interest and board representation (if any).
**Spin-off IPOs:** When a company identifies a subsidiary or line of business that is no longer core to its strategy, it may sell it to the public. In a spin-off IPO, the “Newco” is separated from its parent and a portion of its ownership offered to new investors through an IPO. The new public company has to establish its own board and governance structures.

**Other:** IPOs also come from other sources: private companies backed by domestic and non-US corporations, founders, and families.

Exhibit 1.1 shows the frequency of these various types of IPOs in recent years.

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**Interview insights**
One of the most dangerous parts of a spin is having management at the parent assume they know what it means to run the subsidiary as a stand-alone public company.  
—Legal advisor

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**Interview insights**
In a spin, you have to determine who is making governance decisions—the parent or the new company.  
—Legal advisor

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**Interview insights**
For investors, things like dual class structures are red flags.  
—Investor

Whatever its origin, even after a company goes public it may still be controlled by the founders or major investors. Sometimes they do this by retaining more than 50% of the class of stock issued in the IPO. Other times, they retain control through a second class of stock that has preferential voting rights. Institutional investors are particularly sensitive to a dual-class voting structure and the perceived disconnect between economic interest and voting power.

A company that meets the criteria for a “controlled company” (as defined by securities and stock exchange regulations, rather than by accounting principles) can choose to adopt certain less prescriptive governance standards (see Section 2.6). As pre-IPO investors sell more of their shares and the company ceases to be “controlled,” additional governance requirements will apply.

**Question to consider:**

- Will you be a controlled company after your IPO? If so, is the control based on voting rights, and what are the implications?
1.2 Impact of the JOBS Act

Many companies and market participants are concerned about the regulatory environment, in particular the cost of regulation.

The JOBS (Jumpstart Our Business Startups) Act became law in April 2012. It’s designed to make it easier for start-ups and small businesses to raise equity in the capital markets. Among other things, the act:

- Raises the maximum number of shareholders a company can have before it’s required to register with the SEC—from 500 to 2,000. The company must still have fewer than 500 investors who are not “accredited investors.” [Securities regulations define accredited investors as individuals meeting specified wealth or income requirements, as well as various categories of institutional investors.] Shareholders who received their shares through employee compensation plans are generally excluded from the count.

- Exempts companies from registration requirements if they have limited-size stock offerings that are sold in small amounts to a large number of investors. This is commonly called “crowd-funding” and often involves selling shares over the Internet.

More importantly, for companies considering an IPO, the act creates a new designation: “emerging growth company,” or EGC. Companies are allowed to maintain the designation for up to five years, essentially creating an “IPO on ramp.” It permits EGCs to:

- Gauge the interest of institutional investors in a contemplated securities offering even before filing with the SEC.

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1 Some provisions of the JOBS Act are not effective as of this writing, pending rule making by the SEC.

2 Companies lose the designation if their revenue exceeds $1 billion, they become a “large accelerated filer,” or they issue $1 billion in nonconvertible debt in any three-year period.
• Make oral and written offers to qualified institutional investors before or after filing registration statements

• Submit their IPO registration statements for initial SEC review on a confidential basis. This is intended to allow the company to get SEC feedback without its competitors gaining early access to the EGC’s confidential information on markets, business plans, risks, and various metrics. Plus, if the company ultimately decides not to IPO, this confidential information remains so.

• Submit two years of audited financial statements with their IPO registration statement, compared with three years that are required for companies that don’t qualify as EGCs

• Include only two years of selected financial information in their IPO registration filing, compared to the five years that non-EGCs must include

• Elect to adopt any new or revised accounting standards using the same time frame as private companies (if the standard also applies to private companies)

• Comply with the SEC’s alternative executive compensation disclosure for smaller reporting companies, which permits them to disclose detailed compensation information for fewer executives, and does not require them to include a “compensation discussion and analysis” section

While a company is an EGC, it does not have to:

• Comply with the internal control external audit requirements of the Sarbanes-Oxley Act section 404(b)\(^3\). (Note: Management will still have to report on its assessment of the adequacy of internal control over financial reporting.)

• Comply with various Dodd-Frank Act compensation requirements, such as holding say on pay and say on golden parachute votes, or disclosing pay-for-performance and CEO pay ratio information

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\(^3\) Smaller reporting companies, generally those with public float of less than $75 million, are also not required to have an external audit report on internal control.
While the JOBS Act is intended to ease the process for companies that want to raise capital, some investor groups have expressed concern over some of the changes, including the lack of external auditor attestation of internal controls during the five-year on-ramp period, and the reduced number of years of audited financial statements required under the law.

Are companies taking advantage of JOBS Act provisions? Many are, but a PwC analysis of 2012 IPOs shows companies are not necessarily using all the provisions. Of the 146 IPOs completed in 2012, 75 (51%) filed as an EGC. Of those, 18 (24%) filed confidentially. And 80% of EGC IPO companies provided three years of income statement and cash flow data, instead of two. Almost two-thirds (63%) provided five years of selected financial information.

So for directors, it’s important to discuss the benefits and any potential drawbacks of being an EGC filer and to recognize these may evolve as the market and investors have more experience with EGC offerings.

**Questions to consider:**

- Does your company qualify to be classified as an emerging growth company (EGC)?
- How might potential investors view the attractiveness of your shares, or the risks of investing in your company, if you provide the reduced level of disclosures allowed as an EGC?
- If you are an EGC, are you planning to voluntarily adopt any of the accounting, auditing, or disclosure provisions beyond what would be required? If so, which ones and why?

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4 Although the JOBS Act was passed in April 2012, it allowed companies that qualified to retroactively designate themselves as EGCs if their first sale of common equity securities was on or after December 9, 2011.
1.3 How directors add value

Taking a company public is a challenging process. There is a great deal of guidance available from accounting and law firms that describes the detailed steps. Appendix D provides an overview of the process.

Experienced public company directors, particularly those who have previous IPO experience, can help executives understand what it takes to successfully transform from a private to a public company. Discussions between management and directors could cover:

- Advice on the IPO process, the issues involved, and the pitfalls to avoid.
- Contacts and connections in the IPO community, including to other potential directors, advisors, investors, and underwriters.
- Whether there are competent executives in key positions, especially since the registration statement will have to describe their business backgrounds.
- Whether the company has the right advisors—especially accountants, auditors, and securities lawyers.
- Whether the company is selecting a suitable lead underwriter, one with:
  - The most favorable distribution channels, based on the company’s needs
  - Analyst coverage and industry expertise
  - Recent experience with deals of comparable size
  - A record of actual deal values that is consistent with estimated values
  - A good reputation among lawyers, accountants, and other advisors

**Interview insights**

Management talks about being a public company without fully understanding what kind of prep work they’ll need to do.

—Director

In my view, you should have a few independent directors and establish an audit committee one year before you go public. That allows the directors to educate and advise management as it gets people, policies, and controls in place.

—Director

Board involvement in picking the underwriters often varies. If the management team has little experience with investment banks, directors can help with perspectives on the industry and the strengths and reputation of analysts.

—Director
• Key corporate governance decisions, including when to bring in additional directors, who they might be, and whether adding other new directors to the board will improve the credibility of the offering and strengthen the company’s reputation.

• The clarity of the company’s business strategy and value proposition, helping frame why an investor should buy into the company.

• The company’s valuation. The pricing committee (which typically comprises a subset of the board, including directors who represent any selling financial sponsors) works with the underwriters to agree on the number of shares to be sold and the price range per share.

• The accuracy of the registration statement. This is especially important given there is liability associated with signing the registration statement. (See an overview of the registration statement contents in Appendix D.)

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**Interview insights**

I took a large company private, then stayed on the board through the subsequent IPO. It was easy to maintain the governance policies and procedures from when it was a public company. I contrast that experience to smaller/midcap companies, where it’s a struggle to institute governance policies and procedures for the first time.

—Director

**Interview insights**

Companies are concerned about the expense of adding outside directors early. But they often underestimate the value of the advice the board can give.

—Director

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**Experienced public company directors can help executives understand what it takes to successfully transform into a public company.**
Building your board
Many decisions about board composition, structures, and practices are needed in conjunction with an IPO. Some will be dictated by regulatory and listing requirements. But for a number of other governance choices, the company has discretion.

It’s understandable that governance decisions may not seem to be as high a priority when compared with the other steps in the IPO process. However, astute directors and executives pay attention to the governance structures and policies the company adopts. Why? Because some governance structures are difficult to change after a company is public. And they send important messages to potential investors about the company’s views on governance.

The largest companies are generally the first to receive pressure from shareholders to adopt certain corporate governance practices. As a result, there are often differences between the governance practices of large and small companies. Frequently, a company going public will choose governance practices that reflect its size, ownership, and state of maturity. It may then modify these practices as the company and its shareholder base grow and evolve.

Where your company has the flexibility to choose among governance options, it can help to understand what other companies are doing. This chapter provides selected benchmarking data. Executives may want to gather additional governance information on companies of similar size, ownership structure, and maturity, as well as the governance practices common in your industry. At the end of the day, the board must take into account its own situation, the company’s stage of development, and the advantages and drawbacks of adopting specific governance practices.

Interview insights
In a spin, a company has a great opportunity to rethink what governance standards make sense, instead of simply changing the name on the parent’s standards.

—Legal advisor

This chapter will help you understand the decisions you need to make about board structures and practices, including:

2.1 Board size
2.2 Board and director independence
2.3 Board composition and director recruitment
2.4 Board committees
2.5 Transition timeline
2.6 Controlled companies
2.7 Board leadership: split or combined chair and CEO
2.8 Director terms: annual or multiyear
2.9 Director tenure
2.10 Scheduling meetings
2.11 Director compensation
2.1 Board size

PwC’s study of IPOs⁵ found the average board size at the time the company’s S-1 registration statement was declared effective was 7.5 directors for noncontrolled companies and 8.3 for controlled companies. As a point of comparison, according to the National Association of Corporate Directors (NACD)⁶, public company boards typically have eight or nine directors, with the largest companies averaging 12. Often the company’s bylaws define the acceptable range for the number of directors.

Some IPO companies find that a relatively smaller board helps to maintain the efficiency and focus of the board’s deliberations. That said, the board needs to be large enough to have a sufficient number of independent directors for the key committees. If a company’s board is too small, it can place a heavy workload on the independent directors. An IPO company that starts out with a smaller board can add directors as the company grows or the board requires additional expertise.

Of course you’ll also need to consider board size in conjunction with independence requirements and other board composition decisions, as discussed next.

Questions to consider:

• What is the ideal size for your board now? When you go public? Once you are public?

• How many directors do you need to recruit? (The independence requirements may factor into answering this question.)

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⁵ Please see description of the study at Appendix E. The designation of controlled versus noncontrolled is based on the company’s structure at the time its S-1 registration statement was declared effective.

⁶ Please see Appendix F for all specific citations for NACD and other studies quoted in this publication.
Both the New York Stock Exchange (NYSE) and the NASDAQ Stock Market (NASDAQ) require that a majority of directors on the board be independent. Each provides a transition period to achieve this, as described in Section 2.5. Controlled companies are exempt from this majority independence requirement. (See Section 2.6 for a discussion of how director independence requirements impact private equity and venture capital firms’ portfolio companies.)

Companies typically disclose in their registration statement which of their initial directors are independent. Companies also have to disclose which directors are independent in their subsequent proxy statements.

Per the NYSE, a director is not independent unless the board affirmatively determines that the director has no material relationship with the company. Per NASDAQ, an independent director cannot have a relationship that, in the board’s opinion, would interfere with his or her ability to exercise independent judgment in carrying out a director’s responsibilities.

Exhibit 2.1 lists the other specific circumstances that would bar a director from being considered independent.

<table>
<thead>
<tr>
<th>Exhibit 2.1: Director independence requirements</th>
<th>NYSE</th>
<th>NASDAQ</th>
</tr>
</thead>
<tbody>
<tr>
<td>Must not have been a company employee in the last three years</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Must not have an immediate family member who is/was an executive officer of the company within the last three years</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Neither the director nor an immediate family member may have received, during any 12-month period in the last three years, more than $120,000 in direct compensation from the company, other than director and committee fees and pension or other deferred compensation for prior service</td>
<td>✓</td>
<td></td>
</tr>
</tbody>
</table>

**Interview insights**

We recruited an extraordinary caliber of independent directors as a private company. We believe investors would expect that, and it has helped our credibility—that’s especially important given the number of less than responsible companies in our industry.

—Executive
### Exhibit 2.1: Director independence requirements

<table>
<thead>
<tr>
<th>Requirement</th>
<th>NYSE</th>
<th>NASDAQ</th>
</tr>
</thead>
<tbody>
<tr>
<td>Neither the director nor an immediate family member may have accepted any compensation from the company in excess of $120,000 during any period of 12 consecutive months within the last three years, other than for (i) compensation for board or committee service, (ii) compensation to a family member who is an employee (other than an executive officer), or (iii) benefits under a tax-qualified retirement plan, or non-discretionary compensation</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>The director is a current partner or employee of the company’s internal or external audit firm; the director has an immediate family member who is a current partner of such a firm; the director has an immediate family member who is a current employee of such a firm and personally worked on the company’s audit; or the director or an immediate family member was within the last three years a partner or employee of such a firm and personally worked on the company’s audit during that time</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>The director or an immediate family member is a current partner of the company’s outside auditor, or was a partner or employee of the company’s outside auditor who worked on the company’s audit at any time during the past three years</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>The director or an immediate family member must not, currently or in the last three years, be or have been an executive officer at another company where any of this company’s executive officers at the same time serve or served on that company’s compensation committee</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>The director is a current employee, or an immediate family member is a current executive employee, of a company that made payments to or received payments from the listed company for property or services in an amount that, at any time in the last three fiscal years, exceeds the greater of: $1 million or 2% of the other company’s consolidated gross revenues</td>
<td></td>
<td>$200,000 or 5% of the recipient’s consolidated gross revenues</td>
</tr>
</tbody>
</table>
PwC’s IPO study shows 56% of directors as of the company’s final S-1 are independent. (See Exhibit 2.2 for how director independence levels change pre- and post-IPO.) Independent directors comprised 68% of the boards of these companies in their most recent proxy. In practice, most public companies have moved beyond having a simple majority of independent directors. Indeed, it’s common for the CEO to be among only one or two nonindependent directors. Spencer Stuart reports 84% of directors at S&P 500 companies are independent.

### Exhibit 2.2: Average percentage of independent directors on the board

<table>
<thead>
<tr>
<th></th>
<th>Noncontrolled companies</th>
<th>Controlled companies</th>
<th>All companies</th>
</tr>
</thead>
<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>
</tbody>
</table>

Source: PwC IPO study

**Questions to consider:**

- Which stock exchange independence rules will apply to you?
- How many of your directors are currently independent?
- What shifts in board composition do you need to make to have a majority independent board? When do you need to do this?

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**Interview insights**

In an IPO context, never underestimate the fact that something emerges that impacts what you’re doing. It can be as simple as a director’s child taking a job at the company’s audit firm, which means the director suddenly isn’t independent.

—Legal advisor

**In practice, most public companies have moved beyond having a simple majority of independent directors.**
2.3 | Board composition and director recruitment

How do you determine what skills and expertise you need on the board? Partly, it’s based on your company’s industry, size, business model, culture, and stage of development. These factors will influence what business skills and experience directors need so they can properly guide and oversee management. Additionally, there are requirements for certain skills—such as financial literacy and financial expertise on your audit committee—that you’ll need to consider.

One approach to looking at board composition is to compare the skills you would like to have with the skills that your directors bring (see Exhibit 2.3). Of course, when you’re considering current directors’ skills, keep in mind any planned departures related to independence or other factors. By identifying any skill gaps, you can better prioritize the most essential traits of prospective director candidates.

As you consider your board’s skills and expertise, also keep in mind that companies have to disclose each director’s skills and qualifications, in both the S-1 and the proxy. Companies also have to disclose what other public company boards each director serves on or has served on during the previous five years. That disclosure may highlight concerns about whether certain individual directors sit on too many boards and whether they have sufficient time to devote to your company’s board. As a point of reference, according to the NACD survey, directors commit on average 219 hours per year to each board on which they serve.
Exhibit 2.3: Board composition grid example

<table>
<thead>
<tr>
<th>Needed skills, experience, and attributes</th>
<th>Director names</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>A</td>
</tr>
<tr>
<td>Financial literacy</td>
<td>X</td>
</tr>
<tr>
<td>Financial expertise</td>
<td></td>
</tr>
<tr>
<td>Industry expertise</td>
<td>X</td>
</tr>
<tr>
<td>International experience</td>
<td></td>
</tr>
<tr>
<td>Operational experience</td>
<td>X</td>
</tr>
<tr>
<td>Technology expertise</td>
<td></td>
</tr>
<tr>
<td>Governmental/regulatory experience</td>
<td></td>
</tr>
<tr>
<td>Social/environmental expertise</td>
<td>X</td>
</tr>
<tr>
<td>Marketing expertise</td>
<td></td>
</tr>
<tr>
<td>Gender diversity</td>
<td>X</td>
</tr>
<tr>
<td>Ethnic diversity</td>
<td></td>
</tr>
</tbody>
</table>

Source: *Board Effectiveness—What Works Best*, 2nd edition, written by PwC

Another aspect to consider in your board’s composition is diversity—a focus area for some investors who believe a diverse board positively affects company performance and better represents the diverse shareholder and stakeholder base. As discussed in Appendix B, companies also have to disclose information about board diversity in their proxies.

How diverse are boards? A 2012 report from the NACD shows that 73% of companies have at least one woman on the board, and 48% have at least one minority director. The percentages are even higher for companies with the highest market capitalization (more than $10 billion), according to the same report.

PwC’s IPO study found 40% of companies identified at least one woman director in their final S-1 and 46% did so in their most recent proxy. It is difficult, however, to determine ethnic diversity from registration statements.

**Interview insights**

We essentially remade our board when we prepared to IPO—only two or three of the original nine directors were still on by the time we went public. We looked for a different set of skills: operational, industry, financial, and diversity. We wanted the strongest board possible to help manage the company’s next stage of evolution.

—Executive

Be very careful and take your time in assembling a board. The board can really shape strategy and succession.

—Director
So how, practically, do you find directors? Many companies rely on recommendations and connections from their current directors, financial sponsors, and executives. They also use director search firms to identify candidates.

Choosing directors for a public company requires important decisions. For one thing, the directors selected will likely serve on the board for a number of years. That’s why it’s important to consider how board candidates will fit within the company’s culture and whether they’ll be able to work well with the other directors over an extended period. This is a sensitive area to assess as you consider candidates. And whether the candidate you’re considering was identified by a current director, by a search firm, or in some other way, it’s important to ensure that you conduct full background checks.

The earlier that new directors are identified and brought into discussions, the better they’ll be able to add value and provide insights. Assembling the post-IPO board sooner allows the directors to develop relationships so they can work together effectively. That said, both directors who sign the registration statement and director nominees are subject to liability. Accordingly, some directors agree to join the board only post-IPO. Our IPO study observed many instances where this was the case. Similarly, directors who won’t remain on the board post-IPO often resign before the company files the initial registration statement.

Newer or smaller companies may face particular challenges in recruiting directors. Potential directors will want to perform due diligence, and if the company has a relatively short track record or lacks an established reputation, director candidates may be less inclined to join the board. Or they may require additional compensation (often in the form of equity) to account for this perceived higher level of risk.

Interview insights

You want to make sure you’re not stuck with directors who don’t want to work. I want my fellow directors to help carry the load and be involved.

—Director

Interview insights

In my view, the fear of exposure to liability from an IPO is way overblown.

—Director

Interview insights

The more time a board can “season,” the better.

—Executive

The earlier that new directors are identified and brought into discussions, the better they’ll be able to add value and provide insights.
Questions to consider:

• Are there any “must-have” attributes you need to consider in prospective directors?

• Do you anticipate any difficulties in attracting the type of director candidates you need?

• How will your shareholders view your board’s overall composition, including breadth of expertise and diversity?

• What types of personality attributes will help a director be effective on your board?

• What is the optimal time to identify and add new directors?

2.4 Board committees

Boards create committees to make the most efficient use of their time. How? They assign a few directors to focus attention on a particular area and then report back to the full board. There are also certain requirements for specific committees, as described in Appendix C.

For instance, both the NYSE and NASDAQ require companies to have audit committees and compensation committees\(^7\) comprised of only independent directors. The NYSE also requires nominating/governance committees—again made up of independent directors. NASDAQ doesn’t require a nominating/governance committee although it does require directors who are independent to discharge that committee’s functions. There are transition provisions for IPO companies to achieve the committee independence requirements, as illustrated in Section 2.5.

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\(^7\) In early 2013, NASDAQ adopted a rule to require independent compensation committees for the first time, with some requirements taking effect by July 2013 and a phase-in period for other requirements, extending to the earlier of a company’s first annual meeting after January 15, 2014, or October 31, 2014.
As discussed in Section 2.6, there are some exceptions to committee requirements for controlled companies.

In practice, even though committee requirements are not consistent across the exchanges, most companies have the three committees described above. Some choose to have additional committees. See Exhibit 2.4.

<table>
<thead>
<tr>
<th>Committees</th>
<th>PwC IPO Study</th>
<th>NACD (median market cap $300 million–$2 billion)</th>
<th>Spencer Stuart (S&amp;P 500 companies)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Per final S-1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Per most recent proxy</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Audit</td>
<td>98%</td>
<td>100%</td>
<td>(not provided) 100%</td>
</tr>
<tr>
<td>Compensation</td>
<td>98%</td>
<td>100%</td>
<td>(not provided) 100%</td>
</tr>
<tr>
<td>Nominating/governance</td>
<td>92%</td>
<td>100%</td>
<td>(not provided) 99%</td>
</tr>
<tr>
<td>Executive</td>
<td>6%</td>
<td>8%</td>
<td>26%</td>
</tr>
<tr>
<td>Finance</td>
<td>8%</td>
<td>8%</td>
<td>16%</td>
</tr>
<tr>
<td>Public policy/social and corporate responsibility</td>
<td>2%</td>
<td>4%</td>
<td>1%</td>
</tr>
</tbody>
</table>

What do the additional committees do?

- **Executive**: Usually handles important issues that arise between regular board meetings. Members typically include the board chair, CEO, lead director, and chairs of the other key committees.

- **Finance**: Typically oversees the company’s capital structure, finance activities, treasury function, mergers and acquisitions, and investment program, among other things.

- **Public policy/social and corporate responsibility**: May oversee environmental trends, workplace safety, corporate political spending, philanthropy, and sustainability.
There are often questions about whether a board needs a risk committee. According to Spencer Stuart, 8% of S&P 500 companies have a board risk committee. The NACD reports 14% of boards have a risk oversight/crisis management committee. Risk committees are most prevalent—and indeed sometimes required—in financial services companies.

Each committee should have a charter that describes its membership requirements, responsibilities, policies, and processes. Indeed, the three major committees must have charters and make them publicly available on the company’s website.

Committee chairs set meeting agendas, lead meeting discussions, and ensure their committees are performing effectively. A chair also delivers the committee’s report to the full board. In selecting a committee chair, consider whether the director has leadership ability and the willingness to commit additional time. Chairs often receive additional compensation for performing this role.

Questions to consider:

- If you don’t currently have an audit, compensation, or nominating/governance committee comprising independent directors, do you need to add a committee or change membership?
- To what extent do you need committees other than the three major ones?
- Do you need to create or revise committee charters?
- How effective is the information flow between individual committees and the full board?

---

**Interview insights**

Be careful when using other companies’ charters to develop your own. They might not represent how your committees function.

—Director

After the IPO, we had to do a lot of cleanup. The standard committee charters we got from our lawyers really didn’t work for us.

—Executive
There are two key dates that impact a company’s governance requirements during an IPO:

**Date registration is declared effective:** When the SEC’s Division of Corporation Finance has reviewed the S-1 registration statement and has no further comments on the financial statements, disclosures, and other information included in the offering, it declares the registration effective, allowing shares to be sold.

**Exchange listing date:** The company’s stock begins to sell on an exchange on this day.

The stock exchanges have developed transition rules for companies going public to comply with certain governance listing requirements as per Exhibits 2.5 and 2.6 below. That said, many companies going public don’t use the transition periods, perhaps wanting to demonstrate their commitment to governance.

### Exhibit 2.5: Timeline for NYSE governance requirements

<table>
<thead>
<tr>
<th>Requirements</th>
<th>Timeline</th>
</tr>
</thead>
<tbody>
<tr>
<td>At least 1 independent director on:</td>
<td>Date registration statement declared effective</td>
</tr>
<tr>
<td>• Audit Committee</td>
<td>Date of listing</td>
</tr>
<tr>
<td>At least 1 independent director* on:</td>
<td>90 days after registration declared effective</td>
</tr>
<tr>
<td>• Compensation Committee</td>
<td>Listing date</td>
</tr>
<tr>
<td>• Nominating/Governance Committee</td>
<td>One year after registration</td>
</tr>
<tr>
<td>Majority independent directors on:</td>
<td>One year after listing</td>
</tr>
<tr>
<td>• Audit Committee</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Fully independent:</td>
<td></td>
</tr>
<tr>
<td>• Compensation Committee</td>
<td></td>
</tr>
<tr>
<td>• Nominating/Governance Committee</td>
<td></td>
</tr>
<tr>
<td>Majority independent directors on:</td>
<td></td>
</tr>
<tr>
<td>• Board of Directors</td>
<td></td>
</tr>
<tr>
<td>* By the earlier of the date the IPO closes or five business days from the listing date</td>
<td></td>
</tr>
</tbody>
</table>

---

**Interview insights**

- **You need to start behaving as if you’re public before you are.**
  —Director

- **It’s my sense that governance structures should be in place four to six months before the offering is priced. Any earlier, and management gets burdened with bureaucracy. But the company does need to grow up.**
  —Executive

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Exhibit 2.6: Timeline for NASDAQ governance requirements

**Requirements**

- At least 1 independent director on:
  - Audit Committee
  - Compensation Committee
  - Nominating Committee (if it exists)

- Majority independent directors on:
  - Compensation Committee
  - Nominating Committee (if it exists)

- Fully independent:
  - Audit Committee

**Timeline**

- Date registration statement declared effective
- 90 days after registration declared effective
- 90 days after listing declared effective
- 90 days after listing

- One year after registration
- One year after listing

**Question to consider:**

- What, if anything, do you need to do to comply with the exchange's governance requirements? What is your deadline for compliance?
2.6 Controlled companies

Both the NYSE and NASDAQ provide exemptions to their governance rules for controlled companies. Generally, both define “controlled companies” as those where 50% or more of the power to elect directors is held by an individual, a group, or another company. Controlled companies are exempt from governance rules requiring:

- A majority of the full board to be independent
- An independent nominating/governance committee
- An independent compensation committee

If a controlled company uses these exemptions, it must disclose that it’s doing so in both its S-1 and proxy.

The portfolio companies that private equity and venture capital firms invest in may fall under the controlled company rules. PE and VC firms typically put their own executives or individuals affiliated with their firms on portfolio company boards. If the PE or VC firm’s exit strategy for a portfolio company involves an IPO, those directors may not be considered independent. That means, among other things, that they likely won’t be able to serve on the audit committee beyond a year after registration.

Post-IPO, PE and VC firms often have a schedule to relinquish board seats as their ownership percentage diminishes. Also, as a firm’s stake decreases, at some point the company may no longer be considered “controlled”—removing the independence exemptions. Once a company ceases to be considered “controlled,” it is allowed a period of time, similar to the transition period for IPO companies, to adopt the additional governance rules that apply.

Questions to consider:

- If you are a controlled company when you go public, do you plan to use any or all of the independence exemptions available?
- If you are a controlled company when you go public, do you anticipate a change in that status? If so, what are the timing and impact?
- Might taking advantage of any controlled company exemptions impact the marketing of your stock?

---

**Interview insights**

As our PE investor sold down its position, we had an agreement that prescribed how its influence on the board would be reduced, to the point where it finally had no ability to name any directors.  
—Executive
2.7  Board leadership: split or combined chair and CEO

The board chair plays a critical role in ensuring the board discharges its responsibilities. The chair needs strong leadership and facilitation skills to be able to focus the board’s efforts on the most important issues.

There are highly divergent views about whether the CEO should also be the board chair. Even if those roles are split it doesn’t mean the board chair is independent. Shareholders often prefer the roles be split and that the chair be independent, and sometimes file shareholder proposals urging this leadership structure. They argue that splitting the roles curbs conflicts of interest, promotes more robust oversight, and enhances CEO accountability.

Practically, it’s very difficult to take the chair role away from the CEO, especially if the CEO is the company founder. And so boards may use a CEO transition as a time to revisit the decision on whether to continue combining the roles. PwC’s 2012 Annual Corporate Directors Survey—reflecting the views of 860 directors—asked directors about this. Almost half of the directors of companies that currently have a combined chair and CEO indicate the board has discussed splitting the roles during the next CEO succession.

Companies have to discuss their board leadership structure in both their S-1 and proxy statement. The need to explain board leadership structure in the proxy has heightened the visibility of this decision.

When the CEO and chair roles are combined, the board often names a lead director. The lead director typically presides over executive sessions of independent directors and communicates with the CEO. He or she also plays a vital role in evaluating individual director performance, conducting the CEO’s performance evaluation, and discussing the results with those individuals.

PwC’s IPO study found 68% of controlled companies and 42% of noncontrolled companies separated the chair and CEO roles at the time the registration statement was declared effective. Of those companies where the roles were split, 8% of the chairs were independent in controlled companies and 46% in noncontrolled companies. See how board leadership evolved after the IPO in Exhibit 2.7.

**Interview insights**

It’s a great idea to have a lead director. It can be less confrontational and gives directors a venue to air concerns.  
—Director
Exhibit 2.7: Evolution of board leadership

<table>
<thead>
<tr>
<th>Noncontrolled</th>
<th>Controlled</th>
</tr>
</thead>
<tbody>
<tr>
<td>Final S-1</td>
<td>Final S-1</td>
</tr>
<tr>
<td>Most recent proxy</td>
<td>Most recent proxy</td>
</tr>
<tr>
<td>42%</td>
<td>68%</td>
</tr>
<tr>
<td>10%</td>
<td>5%</td>
</tr>
<tr>
<td>47%</td>
<td>50%</td>
</tr>
<tr>
<td>50%</td>
<td>25%</td>
</tr>
<tr>
<td>5%</td>
<td>25%</td>
</tr>
</tbody>
</table>

Source: PwC IPO study

In 2012, the chair and CEO roles were separate at 43% of S&P 500 companies, although only 23% had a truly independent chair. The results are similar among a broader cross-section of companies. NACD’s survey reports 42% separate the roles. NACD also notes that for those companies where the roles are combined, 83% named a lead independent director.

Questions to consider:

- If you combine the CEO and board chair roles pre-IPO, do you expect pressure to separate the roles after becoming a public company? If so, how would you respond?

- Which director inspires the confidence to provide independent board leadership as either lead director or chair?

2.8 Director terms: annual or multiyear

When directors serve for multiple-year terms (often three years with one-third of the board elected annually) it’s referred to as a classified board. Classified boards are one form of antitakeover defense. They protect companies from shareholders seeking to alter company strategy by waging a proxy fight to change board composition. That’s why it’s not unusual for investors to propose declassification.
When all directors are nominated for election annually, the board is considered to have a declassified structure. Of course, one possible drawback is that an entire segment of the board—say, the compensation committee—could face challenges to reelection if shareholders are unhappy with these directors’ performance.

Board declassification is more prevalent in larger and more established companies, as shown in Exhibit 2.8, perhaps because larger companies have received more shareholder pressure for declassification.

**Exhibit 2.8: Board declassification by company type**

<table>
<thead>
<tr>
<th></th>
<th>Controlled company</th>
<th>Noncontrolled company</th>
<th>S&amp;P 500 companies</th>
<th>Companies with revenues of $100 million–$500 million</th>
</tr>
</thead>
<tbody>
<tr>
<td>PwC IPO study final S-1</td>
<td>42%</td>
<td>29%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Spencer Stuart</td>
<td>83%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Conference Board</td>
<td>40%</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

In deciding how often to elect directors, astute boards will weigh the advantages of longer director terms against the preferences of their shareholder base. They also realize that even though they can declassify at a later date, it would be highly difficult to move away from annual director elections after an IPO.

**Questions to consider:**

- Will the frequency you use to elect directors still work for the company after going public?
- What frequency of director elections do your major shareholders prefer?
2.9 | Director tenure

Boards may have a policy requiring directors to step down when they either reach a certain age or have been on the board for a specified time. Some directors oppose such measures and believe that placing artificial caps on board service can force directors to leave when they are still adding value. Others believe that limiting service is essential, as it may assist in removing directors who are no longer effective.

PwC’s IPO study found no companies indicating a mandatory retirement age in their final S-1, although 8% had adopted one by their most recent proxy.

According to Spencer Stuart, few S&P 500 boards (only 4%) have term limits. But 73% have a mandatory retirement age, typically between 72 and 75. Mandatory retirement ages are less prevalent at smaller companies, with the NACD reporting that 53% of companies have such policies. A retirement policy isn’t as binding as it may appear, however. Boards may change the retirement age in their policies or choose to extend the service of individual directors.

There are no requirements for IPO companies to adopt any policies on director tenure. But if a board is considering this during an IPO, it should understand the impact of the retirement policy on future board turnover. If many directors are of a similar age, the board could lose a great deal of institutional knowledge in a short period.

Question to consider:
• Should you consider any policies on director tenure, such as an age or term limit?
2.10 | Scheduling meetings

How often do the board and its committees need to meet? According to the NACD, most public company boards meet eight times a year (five times in person and three times via phone). Audit committees have approximately nine meetings, compensation committees six, and nominating/governance committees five.

In planning, companies going public need to consider the number of meetings as well as when and where they should be held throughout the year. Key factors in scheduling include quarterly and annual reporting requirements and the board’s need to monitor the business. Special meetings may be needed to address any time-sensitive issues that arise.

Ideally, all meetings should be scheduled and communicated to directors a year in advance. Providing ample advance notice allows directors to preserve the meeting dates on their calendars. This is important because companies have to disclose in the proxy statement if any director failed to attend at least 75% of board and committee meetings in the prior year. Such directors may find that proxy advisory firms recommend voting against their reelection and they become the target of withhold vote campaigns.

Another scheduling question is whether the various committees’ meetings should be held concurrently or consecutively, prior to the board meeting. Scheduling concurrent meetings is challenging when directors serve on multiple committees.

Questions to consider:

• Will your board need to meet more or less frequently once you become a public company?

• What factors may influence the timing and location of your meetings?

• Would it work better for you to schedule committee meetings concurrently or consecutively?
2.11 Director compensation

Companies going public need to consider the level and type of compensation they’ll pay to their directors. The compensation needs to factor in directors’ time commitment as well as the risks they are assuming.

Director compensation typically includes four elements: an annual cash retainer, meeting fees, stock awards, and stock options.

PwC’s IPO study found companies pay their directors as follows:

- **Cash:** 90% of companies in their final S-1 and 100% of companies in the most recent proxy
- **Equity:** 46% of companies in their final S-1 and 76% of companies in the most recent proxy
- **Options:** 38% of companies in their final S-1 and 32% of companies in the most recent proxy

There is little mention of meeting fees in S-1s.

Companies can find comparative compensation data easily in peer companies’ proxies. Some use a compensation consultant to gather this benchmarking information. As Exhibit 2.9 shows, average total compensation for a director varies greatly depending on company size, according to The Conference Board. As you might expect, the largest companies pay the highest director compensation. Accordingly, for S&P 500 boards, Spencer Stuart reports the all-inclusive compensation per director exceeds $242,000.
Exhibit 2.9: Average annual public company director compensation

<table>
<thead>
<tr>
<th>Company revenue</th>
<th>Cash retainer</th>
<th>Meeting fees</th>
<th>Full-value shares</th>
<th>Stock options</th>
<th>Total compensation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $100 million</td>
<td>$35,033</td>
<td>$16,643</td>
<td>$26,895</td>
<td>$90,918</td>
<td>$86,759</td>
</tr>
<tr>
<td>$100 million–$499 million</td>
<td>77,106</td>
<td>13,175</td>
<td>122,603</td>
<td>65,015</td>
<td>181,411</td>
</tr>
<tr>
<td>$500 million–$999 million</td>
<td>69,341</td>
<td>27,031</td>
<td>137,426</td>
<td>45,962</td>
<td>213,040</td>
</tr>
<tr>
<td>$1 billion–$4.9 billion</td>
<td>66,800</td>
<td>24,535</td>
<td>81,155</td>
<td>72,218</td>
<td>165,025</td>
</tr>
</tbody>
</table>

Source: The Conference Board [Note: Total compensation in the exhibit does not equal the sum of the compensation elements because not all companies award each type of compensation.]

Many boards also have policies requiring directors to hold shares in the company—typically valued at some multiple of their annual cash retainer. Almost 90% of companies with more than $5 billion in revenue have such policies; only 44% of companies with revenues less than $500 million do, according to The Conference Board.

Questions to consider:

• What information do you need to determine the appropriate level of compensation to pay your directors?

• Do you have the right mix of director compensation to align directors’ interests with those of shareholders?

• Should you set minimum stock ownership requirements for directors?

Director compensation needs to factor in directors’ time commitment as well as the risks they are assuming.
Understanding key governance influences
As a company moves toward its IPO, the board should prepare to operate in a different environment—one that brings much more attention to its governance practices. A number of external influences and factors may affect the governance practices you choose to adopt.

Additionaly, proxy voting has grown increasingly complex as a result of a number of interrelated factors:

- The growing influence of proxy advisory firms
- Changes to rules about brokers’ voting of shares without their customers’ instructions
- More companies moving from plurality to majority voting
- The use of “empty voting” to influence election outcomes
3.1 Investor profile

Different investors have different strategies and time horizons. For example, some investors look for long-term gain, while others may be interested only in a short-term run-up in the stock price. Companies may need to find a way to manage through such conflicting objectives.

As a company grows and its public profile increases, it may attract additional investors who bring different expectations of its governance practices. This is particularly true when a company reaches a size where it is added to an index—which will tend to broaden its shareholder base. If institutional investors offer an index fund, they don't have the option to sell a company’s shares if they’re displeased with corporate performance. So they may look to governance activism as one of their few options to engage the company.

By understanding the different types of investors and the expected makeup of your company’s shareholder base, you can better understand the pressures your company may face.

US equity ownership has shifted significantly from individual investors to institutional investors such as mutual funds, public pension funds, and labor funds. According to the most recent available report from The Conference Board, institutional investors’ proportion of the equity in the largest 1,000 US companies rose to 73% in 2009 from 47% in 1987.

These institutional investors don’t all think alike, though. They have different investment strategies, corporate governance voting policies, company engagement styles, and shareholder activism histories.

Some large institutional investors use shareholder activism to advance their preferred corporate governance practices. They exert their influence in two main ways: by directly engaging with a company to change its governance and by filing shareholder proposals. Institutional investors with a history of corporate governance engagement and activism include:

- The California Public Employees Retirement System (CalPERS)
- The California State Teachers Retirement System (CalSTRS)

Interview insights
I don’t think governance structures make any difference to investors who are buying the IPO— they’re buying based on the roadshow. But governance could impact decisions of subsequent investors, and have longer-term implications.

—Director
Understanding key governance influences

• Teachers Insurance and Annuity Association—College Retirement Equities Fund (TIAA-CREF)

• American Federation of Labor—Congress of Industrial Organizations (AFL-CIO)

• American Federation of State, County and Municipal Employees (AFSCME)

• The United Brotherhood of Carpenters and Joiners of America

Under the Employee Retirement Income Security Act (ERISA), fund trustees have a fiduciary responsibility to vote the proxies of the companies in their portfolio in the best interests of fund participants and beneficiaries. These investors, and many others, belong to and coordinate their efforts through the Council of Institutional Investors (CII). CII is a nonprofit, nonpartisan association of pension funds and other employee benefit funds, foundations, and endowments with combined assets that exceed $3 trillion. Among other things, it advocates strong shareowner rights.

When major shareholders have concerns, they’ll sometimes reach out to the company to discuss them. If they feel the company isn’t responding, they may choose to file a shareholder proposal so all shareholders can vote on the matter. But not all proposals make it into the proxy. Companies may seek the SEC’s approval to omit certain proposals, especially ones that deal with “ordinary business.” Companies also sometimes reach an agreement on the issues with their investors, who then withdraw the proposal before a vote occurs.

Still, many proposals do go forward to the proxy. These often fall into two categories: general corporate governance and social issues. Exhibit 3.1 lists the most common shareholder proposals filed in each category in 2012.

By understanding the different types of investors and the expected makeup of your company’s shareholder base, you can better understand the pressures your company may face.
Exhibit 3.1: Most common shareholder proposals in 2012

<table>
<thead>
<tr>
<th>Area</th>
<th>Description</th>
<th>Average shareholder support</th>
</tr>
</thead>
<tbody>
<tr>
<td>General governance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Board declassification</td>
<td>46 proposals actually voted on, for annual director elections (to replace staggered terms)</td>
<td>81%</td>
</tr>
<tr>
<td>Majority voting</td>
<td>37 proposals went to a vote, asking to move from plurality to majority voting</td>
<td>62%</td>
</tr>
<tr>
<td>Independent board chair</td>
<td>48 proposals voted, seeking to split the roles of chair and CEO</td>
<td>36%</td>
</tr>
<tr>
<td>Proxy access</td>
<td>21 proposals for shareholder access to the proxy; 9 proposals actually voted</td>
<td>36%</td>
</tr>
<tr>
<td>Social issues</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Political contributions disclosure</td>
<td>116 proposed; 71 actually voted, asking companies to disclose corporate political spending</td>
<td>26%</td>
</tr>
<tr>
<td>Sustainability</td>
<td>30 proposed; 9 actually voted, asking companies to include reports on sustainability efforts</td>
<td>35%</td>
</tr>
<tr>
<td>Hydraulic fracturing disclosure</td>
<td>10 proposed; 3 actually voted, seeking disclosure about natural gas fracturing activities</td>
<td>31%</td>
</tr>
</tbody>
</table>

Source: Institutional Shareholder Services, 2012 Proxy Season Review: United States

The reality is that many shareholder proposals target larger, high-profile companies. That said, some institutional investors who succeeded in having large companies adopt measures like majority voting are now asking the next tier of companies to do the same. And so smaller companies, including those that are newly public, cannot assume they will remain under the radar on some of these common shareholder issues.

If a shareholder proposal at a company passes, the company shouldn’t automatically adopt it. Directors need to consider whether what shareholders are seeking is in the company’s and other shareholders’ best interests. If it’s not and directors choose not to adopt it, they should carefully communicate the factors influencing their decision. This is particularly important, given it may impact proxy advisory firms’ recommendations on their reelection in subsequent years. (Section 3.3 discusses proxy advisory firms and their impact.)

Private investment funds often take a different approach to governance activism—typically targeting companies they believe to be undervalued.

Interview insights
You made a choice to take other people’s money. Now you have to deal with the issues that come along with that.
—Director
Rather than seeking corporate governance reforms, they’re more likely to seek board representation, special dividends, share buybacks, or significant shifts in corporate strategy. Generally these funds first try to engage a company and obtain concessions. If dissatisfied with the result, they may decide to engage in a public proxy fight—which can be costly and distracting to management.

As you transition to being a public company, you’ll have to consider the best way to connect with your shareholders. And it may be challenging even to understand who they are, as those investors who buy your shares during the IPO won’t necessarily hold onto them. So one issue you should discuss with your underwriters and consider more broadly is how you can attract long-term, stable shareholders.

How do other companies handle relationships with investors?
Typically, through an investor relations (IR) function, which handles communications with not just shareholders, but also with securities analysts, proxy advisory firms, and others in the financial community. IR also coordinates with a number of areas within a company, including finance, corporate communications, marketing, and securities law compliance. In medium and larger public companies, IR is typically a separate department. For smaller companies, the duties may be outsourced or handled by another group. Whether you have a separate function or not, it’s helpful to have someone named to handle investor relations by the time you go public.

Questions to consider:

- What is the anticipated ownership mix (founders, company executives and employees, institutional, private equity, retail, etc.) in the company’s shareholder base?
- Might your anticipated shareholders have concerns about your governance practices that could make you a likely target for shareholder activism or proposals?
- How are you planning to handle investor relations, and are you satisfied with your strategy to build relationships with proxy advisory firms and shareholders?
- Should you build any antitakeover defenses into your organizational and corporate governance documents before you go public?

Interview insights
Many companies overlook the importance of the investor relations function.

—Director
3.2 Shareholder voting

Plurality voting is the most widely used method at US public companies. Under this approach, shareholders have the option to vote “for” a director or to “withhold” their vote. Directors receiving the most votes “for” are elected. In an uncontested election (where, for example, eight directors are nominated for eight board seats), a director nominee theoretically needs only one vote “for” to be seated. That means, for example, 99% of shareholders can withhold their support and the director still will be elected. Plurality voting is the default standard under Delaware state law, where many companies are incorporated.

With majority voting, a director nominee must receive more than 50% of the total votes cast. Although companies use different versions of this system, a director nominee who doesn’t receive a majority of votes generally will submit his or her resignation for the board’s consideration.

Larger companies have increasingly adopted majority voting. According to Spencer Stuart, 84% of S&P 500 companies have done so, largely as a result of shareholder activism. The Conference Board notes that approximately 25% of companies with revenues less than $10 billion use majority voting.

This issue is gaining prominence. There are numerous “withhold vote” campaigns organized by investors and targeted at certain directors—often those on compensation or audit committees. Past years have seen a handful of directors resign following successful withhold vote campaigns. Even if a director survives such a campaign, there are still reputational concerns.

**Question to consider:**

- What are the advantages of adopting majority versus plurality voting at this stage?
3.3 Proxy advisory firms

Proxy advisory firms provide recommendations—based on their policies—to institutional investors on how to vote at annual meetings. By some estimates, proxy advisory firms directly influence between 15% and 25% of shares voted—and many believe they indirectly influence far more. In PwC’s 2012 Annual Corporate Directors Survey, 31% of directors responded that they believe these firms influence more than 30% of the shares voted.

The two largest and most influential proxy advisory firms are Institutional Shareholder Services (ISS) and Glass Lewis. Both post their policies on their websites.

Proxy advisory firms prepare reports for each company they evaluate. You should get and review a copy of your report. Especially in your first year as a public company, and when you’re changing governance practices, you will want to make sure the proxy advisory firms have accurately captured your policies and practices.

Particularly since mandatory say on pay votes⁸ started in 2011, companies have responded vigorously when proxy advisory firms issued negative voting recommendations. In some cases, companies changed their compensation policies before the vote. In others, they issued supplementary proxy materials to better explain their decisions. They also conducted further outreach to their shareholders. (Under the JOBS Act, emerging growth companies are not required to have say on pay votes. See Section 1.2 for further discussion of the JOBS Act.)

Many institutional investors also have their own voting policies on governance issues. They generally consider both their own policies and the recommendations of proxy advisory firms before casting their votes in director elections and on shareholder proposals.

Interview insights
The stock exchange rules aren’t the only thing to consider when assessing the independence of potential directors. ISS also has its criteria, which in some ways is stricter. If a company isn’t careful, it may end up with directors on key committees that ISS is recommending a vote against.

—Legal advisor

⁸ The Dodd-Frank Act gives shareholders an advisory vote on executive compensation.
You need to make governance, compensation, and operational decisions that reflect the needs of your company and its stage of development, to best support its growth. But as you do so, it’s helpful to understand the extent to which your policies and actions might conflict with the policies of your major shareholders and the proxy firms advising them. Understanding those gaps may lead you to alter your approach, or to more fully explain the rationale behind your decisions in your proxy disclosures, or even to reach out directly to selected shareholders.

**Questions to consider:**

- How do your governance policies compare to the voting policies of the proxy advisory firms and the major investors you want to attract?
- At what point might you need a plan to deal with possible negative voting recommendations or “withhold” vote campaigns against directors?

### 3.4 Changes to broker voting rules

Historically, brokers were allowed to use their discretion to vote the shares they held on behalf of a customer on “routine matters” if the shareholder didn’t provide instructions on how to vote. Director elections and company-supported governance proposals were considered routine, and brokers usually voted with the board’s recommendations.

The 2010 Dodd-Frank Act prohibits brokers from voting without shareholder instructions on executive compensation issues such as say on pay and say on golden parachutes.

In 2009, the NYSE prohibited brokers from discretionary voting in director elections. Then in 2012 it further barred brokers from using their discretion to vote without shareholder instructions on other corporate governance proposals, including:

- Declassifying a company’s board of directors
- Changing to majority voting when electing directors
- Eliminating supermajority voting requirements in company bylaws
• Allowing shareholders to act by written consent instead of requiring a meeting
• Providing shareholders the right to call a special meeting
• Eliminating antitakeover provisions such as poison pills

As a result, a company can no longer rely on the votes that brokers historically cast in support of company recommendations. This could make a difference in whether a given proposal passes. It may also increase the impact of proxy advisory firms' recommendations.

Individual (retail) investors are less likely to provide voting recommendations to their brokers. Accordingly, if you have a disproportionately large individual investor base, you might want to consider additional ways to encourage these investors to vote their shares.

**Question to consider:**
• What impact do you think the broker nonvote rules will have on your proxy voting results?

### 3.5 Empty voting

Empty voting enables shareholders to boost their voting power in a company without having the equivalent financial interest. They typically do this by “borrowing” shares from other investors. If an institution or a firm is holding borrowed shares on the record date, it can vote these shares at the annual meeting. Some activist shareholders use empty voting to influence director elections, particularly in proxy fights.

Many companies are concerned about empty voting and there is some pressure for regulators to address it. While public companies really can’t control this, it’s important to be aware of this phenomenon, especially if your company is being challenged.
4

Protecting directors
As a company moves toward its initial public offering, directors—especially those who are new to public company service—will want to understand their legal obligations. They should also understand how best to protect themselves if issues arise at the company. This chapter generally describes key legal concepts relating to director responsibilities and protections. Directors and executives should seek legal counsel to discuss how these matters affect you. In particular, you’ll want to understand any specific implications given the company’s state of incorporation.

4.1 Fiduciary duties

By accepting a role on a board, directors assume certain legal duties to the company and its shareholders. If there are disputes about the actions a board has taken, the courts judge director conduct based on whether directors have fulfilled their fiduciary duties.

A majority of US companies incorporate in Delaware because they believe the state has a well-developed and stable legal environment for business. Delaware’s court system is also recognized for quickly and competently addressing corporate legal issues. Under the laws of Delaware and many other states, directors have two fiduciary duties:

- **Beneficial Duties**: Directors have a duty to act for the benefit of the company and its shareholders. This includes making decisions that are in the best interest of the company and its shareholders.
- **Careful Duty**: Directors have a duty to exercise care and diligence in making decisions. This includes conducting reasonable investigations and seeking expert advice when necessary.

The Delaware courts have developed a standard for determining whether a director has fulfilled their fiduciary duties. This standard is known as the “business judgment rule,” which allows directors to make decisions in good faith without being second-guessed by the courts. However, if a director’s decision is not reasonable or is made with a disregard for the duties owed to the company, the director may be held liable for any losses or damages resulting from the decision.

Interview insights

If you’re going to be on a public company board, you need to understand you have some very serious fiduciary duties. It’s not just attending quarterly board meetings.

—Director
• The **duty of care**, which requires them to exercise diligence and make informed decisions. Directors must commit appropriate time to their deliberations, consider material information relevant to their decisions, and exercise prudent judgment. In practice, what does this look like? It involves asking probing questions of management and seeking additional information—perhaps also seeking outside expertise if needed for directors to reach informed decisions.

• The **duty of loyalty**, which requires them to always put the interests of the company and shareholders before their own. This means directors should disclose to the board situations in which they have a conflict of interest and recuse themselves from participating in decisions relating to that matter. As part of the duty of loyalty, directors have a corollary duty to act in “good faith.”

As we mentioned in the Section 2.6 discussion on controlled companies, private equity firms and other financial sponsors may put their own executives or individuals affiliated with their firms on portfolio company boards. Some of these directors may not fully recognize that, when serving on the board, they owe fiduciary duties to the portfolio company and **all** shareholders.

In a few states, directors legally owe fiduciary duties to a broader group beyond the company and its shareholders. This could include employees, suppliers, and the communities in which the company operates. And in the case of an insolvent company, directors’ fiduciary duties may expand to considering creditors’ interests.

One of the ways to demonstrate your board is fulfilling its duties is through appropriate board (and committee) meeting minutes. Combined with an archive of the materials used in the meeting, these records provide evidence that the board engaged in a robust deliberation process.

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**Interview insights**
Once we were public, we realized there were a number of processes we needed, including some agreement on how we were going to prepare board and committee meeting minutes.

—Executive
There are differing views on minutes. At a minimum, the minutes should indicate who attended the meeting and that the board undertook a considered process in reaching key decisions. What level of detail should minutes contain? Public companies need to strike the balance between bare bones minutes and those that resemble transcripts. This is a key area where you may wish to consult with counsel on what makes sense for your board.

The business judgment rule is a critical legal concept that relates to directors’ duties. Under this rule, courts—absent evidence to the contrary—presume that directors have complied with their fiduciary duties when making business decisions and will not reevaluate the merits of decisions made in good faith and with due care. So even if the decision turns out poorly—say, an investment in new technology doesn’t pay off—the directors generally won’t be found liable.

Pursuing opportunities involves taking risks. Without the protection the business judgment rule offers, some directors might be reluctant to approve management’s plans to pursue new initiatives.

**Questions to consider:**

- Is your board’s decision-making process thorough, appropriately documented, and in the best interests of your company and its shareholders?

- Does your board get the information it needs from management to make sound decisions? Does it use outside advisors when needed?

- Are you staying current on court decisions that can affect fiduciary duties or the protections of the business judgment rule?

- Do you understand to whom you owe fiduciary duties?
4.2 Director protection measures

There are a number of ways to protect directors from losses due to lawsuits. These measures are important because defending against claims can be time consuming and costly.

**Limitation on liability.** Delaware and other states’ laws permit a company to provide in its certificate of incorporation that directors will not be personally liable to the corporation for monetary damages arising out of breaches of their fiduciary duty. This limitation doesn’t apply to breaches of the duty of loyalty, or to actions not made in good faith or involving intentional misconduct or knowing violations of law. Companies planning to go public invariably include such a provision.

**Indemnification.** Legal costs or settlements that result from directors’ board service can be indemnified. This means the company—either using its own funds or leveraging directors and officers (D&O) insurance—will advance or pay board members’ legal costs for claims.

The extent of indemnification is usually described in corporate documents such as articles of incorporation, bylaws, or indemnification agreements. Indemnification is an important protection measure for directors, even for those at companies that purchase significant levels of D&O insurance. In fact, most D&O insurers require a company to indemnify its directors and officers to the fullest extent allowed by law.

**Directors and officers insurance.** This insurance protects your board members and officers from the cost of legal claims made against them in performing their corporate roles. D&O insurance also allows companies to be reimbursed when they do indemnify their directors. In addition, a D&O policy provides coverage for directors when corporate indemnification is not available, whether because the company is legally prohibited from doing so or is insolvent. D&O policies do not, however, cover fraud by directors or intentional violations of law.
Protecting directors

D&O policies usually offer three types of coverage:

- **Side A**—Covers the director or officer for personal losses resulting from certain wrongful acts that can’t be indemnified by the company, either because of the corporate bylaws or because the company is insolvent. It is sometimes referred to as “catastrophe” insurance.

- **Side B**—Is reimbursement coverage that pays the company back for amounts it pays out on behalf of its directors and officers for defense costs, settlement amounts, or judgments. It’s used to protect the company rather than individual directors.

- **Side C**—Covers the company for losses resulting from the company’s own wrongful acts.

Generally, Side A coverage has no deductible, but Sides B and C have large deductibles. Companies negotiate D&O policies to cover their specific needs.

In addition to understanding the types of coverage, directors will want to understand how the D&O policies address such matters as:

- **Severability**—Whether the policy states that conduct or representation by one director or officer won’t preclude coverage for the other directors or officers.

- **Rescission**—Factors that could cause the insurance company to void a policy and deny coverage. To do so, the insurer must prove that the company made a material misrepresentation when it applied for coverage—that it either intended to deceive or materially misrepresented circumstances that would have affected the insurance company’s decision to issue the policy.

- **Limits of liability**—Monetary caps on each portion of the limits available from the D&O policy. It is rare but possible that the policy limit can be reached defending the company and officers, leaving no coverage for the director(s). As a result, many companies purchase additional “Side A” coverage on top of their standard D&O policy.

It’s common for companies to revise their D&O policies and increase coverage levels when they go public.

*Interview insights*

Directors need education on D&O policies, but the reality is we understand the differences between Side A and Side B for about 10 minutes.

—Director
Individuals in the company who negotiate insurance coverage are often under pressure to reduce premium costs. This pressure to manage costs may be especially true in smaller companies and in companies going public. Accordingly, directors will want to ensure that reductions in cost don’t come at the expense of adequate coverage, and so may wish to have the D&O policy reviewed periodically by outside counsel. Although it’s not common, some directors purchase personal liability insurance in addition to what their companies provide.

**Questions to consider:**

- Does your board fully understand how directors are covered under the company’s indemnification and D&O insurance?
- Are you comfortable with the level of D&O coverage?

### 4.3 Director orientation

A robust orientation process helps new directors contribute to boardroom discussions and exercise their oversight responsibilities more effectively. New directors should expect a comprehensive briefing on the company’s:

- Business
- Industry and the competitive landscape
- Strategic business plans and projections
- Key risks and crisis management plan
- Executive team bench strength
- Financial statements, budgets, and forecasts
In addition, new directors should expect to meet with key executives and tour the company’s facilities. It is also helpful for new directors to meet with other directors (usually the chair, lead director, and/or committee chairs) who can help them better understand the board’s dynamics. Ideally, the corporate secretary provides new directors with an orientation package including recent agendas, meeting materials, and minutes, as well as the company’s bylaws, corporate governance principles, committee charters, code of conduct, and insider trading policy.

New directors will also likely receive additional orientation based on their committee service. For instance, new audit committee members might begin by reviewing financial reporting with the CFO and key members from finance and the external audit team. This orientation might also cover how the audit committee discharges its other core responsibilities over areas such as compliance.

**Questions to consider:**

- Is there a robust director orientation to maximize director and board effectiveness?
- Do you provide opportunities for new directors to meet with other directors on the board as part of their acclimation?

A robust orientation process helps new directors contribute to boardroom discussions and exercise their oversight responsibilities more effectively.
5

Being public—preparing for the first year out
Completing the IPO process is a major accomplishment in a company’s evolution. But your governance work doesn’t end with going public. Being public brings additional considerations, especially the need to communicate and connect with shareholders.

**This chapter helps you navigate some of the governance basics you’ll face in your first year as a public company, including:**

- **5.1 Proxy statement**
- **5.2 Proxy solicitors**
- **5.3 Annual meeting of shareholders**
- **5.4 Director-shareholder communications**

### 5.1 Proxy statement

The proxy statement is a key vehicle for communicating governance matters to your shareholders. Shareholders use proxies to vote on director elections and executive compensation, among other matters. Regulators review proxies for compliance with disclosure rules. Other parties (such as proxy advisory firms and potential investors) also use the proxy to gain perspectives on the company’s corporate governance practices.

Companies need to allocate sufficient resources to compile information for the proxy to meet the filing deadline. Often the general counsel takes the lead in assembling the information that goes into the proxy and ensuring it meets disclosure requirements. The proxy must include detailed information about a number of areas (see Exhibit 5.1), including specific board-related disclosures. (See a description of these in Appendix B.) Much of the governance information needed for the proxy will already have been compiled for the registration statement. And so the process is in many respects one of supplementing and updating information versus creating it from scratch. Management can also look to other companies’ proxy disclosures.
Directors should read the company’s proxy carefully—especially in the first year. In part, directors will want to make sure you’re comfortable with the way management is describing the board’s processes and directors’ backgrounds. In subsequent years, directors should understand how management is revising proxy statements. Revisions may be needed to reflect changes in the board’s governance practices, to respond to new required proxy disclosures, and to reflect changes agreed to with the SEC, investors, or other parties.
Many investors look to the proxy to more fully understand the rationale behind compensation decisions, as well as other decisions about the board’s governance structure. A leading practice is to use plain English, graphical displays, and executive summaries, and to provide supplementary materials on the company website.

**Questions to consider:**

- Do you understand the full scope of information you need to report?
- Do you have the right resources in place to compile the proxy?
- Do you have a strategy for drafting the proxy in a way that’s consistent with the company’s shareholder communications strategy?

### 5.2 Proxy solicitors

Proxy solicitors can help companies engage with shareholders throughout the year and particularly during the proxy voting period. The solicitor may:

- Assist a company in better understanding its overall shareholder profile, the historical proxy voting practices of its larger institutional investors, and the influence of ISS, Glass Lewis, and the other proxy advisory firms.
- Review the preliminary proxy material for any corporate governance “red flags,” and determine the most effective solicitation strategy.
- Develop and execute a strategy to solicit votes from specific groups of shareholders and proxy advisory firms. This approach may involve letters, emails, phone calls, or meetings, and may differ for different groups.
- Try to influence how shareholders will vote their proxies, especially when the vote concerns a contentious management or shareholder proposal, a proxy fight, or a major transaction such as an acquisition.
- Monitor voting returns throughout the voting period to gauge whether shareholder outreach efforts need to be adjusted.
Not all companies use proxy solicitors for the services outlined above. As a new public company, you may want to identify a proxy solicitation firm to use so you can react swiftly if you find you’re facing a close vote on a particular issue. Or you may decide to engage proxy solicitors only on an as-needed basis.

**Questions to consider:**

- Do you need a proxy solicitation firm, and if so, what should the nature of the relationship be?
- Do you need a strategy to encourage your retail shareholders to vote?

### 5.3 | **Annual meeting of shareholders**

Annual meetings allow companies to transact business that requires shareholder approval, such as director elections. Public companies must:

- Hold an annual shareholder meeting, the timing of which is specified in the company’s bylaws and, in some cases, by state law.
- Notify shareholders of the annual meeting date.
- Post the proxy materials online and notify shareholders when they are available. (Companies may also mail proxies to some or all of their shareholders.)
- Have a quorum of shares represented for the votes to be considered valid. The company’s bylaws will specify what constitutes a quorum.

Apart from the regulatory requirements, you’ll also have to address some logistical considerations:

**Meeting venue.** For simplicity, many companies hold the meeting at their corporate headquarters, which is likely the least expensive and least disruptive venue. Some use operating locations. Others choose to use outside conference facilities.
Typical attendees. Shareholders are invited to attend the annual meeting. Other attendees often include key executives, directors, a representative of the external audit firm, outside counsel, proxy solicitors, and vote tabulators. Depending on your company’s profile, members of the media may also attend. It’s important to note that director attendance is key, given that companies have to disclose the number of directors who attended the meeting in the next year’s proxy.

Shareholder questions. In practice, most companies find that few shareholders attend the annual meeting. However, it’s helpful to anticipate likely shareholder questions and prepare responses. Also, your company should consider what ground rules to set for shareholder Q&A, such as time limits per question and for the entire question period. You also need to consider who will answer the questions. Typically, the CEO takes the lead in responding. However, the board should identify an independent director to respond to questions that may be best answered by the board. This will likely be the independent chair, lead director, or chairs of major committees.

Security. Even for small companies, the fact that all the company’s directors and senior executives are in one location makes it prudent to consider security issues. Security can play two key roles: ensuring that only authorized individuals are allowed into the annual meeting and dealing with any disruptive attendees.

Questions to consider:

• Do you have the right resources involved in planning the annual meeting and a comprehensive plan to address all needed elements?

• Do you anticipate any disruptive behavior at your annual meeting?

In practice, most companies find that few shareholders attend the annual meeting.
5.4 Director-shareholder communications

In Section 3.1 we discuss how shareholders have different objectives and approaches for expressing their concerns. In some cases, shareholders want to talk with directors.

Experienced directors know that, before even considering communicating with an investor, they need to coordinate messaging with the company and understand the implications of Regulation Fair Disclosure\(^9\). Companies typically have policies on who can communicate on behalf of the company. Such policies ideally should also cover the extent to which directors are permitted or expected to participate in any communications, and if so, on which topics and with which groups of investors or others outside the company.

As Exhibit 5.2 shows, directors have varying levels of communication with different stakeholders.

### Exhibit 5.2: Directors’ views on their role in communications

<table>
<thead>
<tr>
<th>During the last 12 months, has your board participated in communicating substantive issues to:</th>
<th>Percent of directors who responded…</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Yes, and it has increased</td>
</tr>
<tr>
<td>Institutional shareholders</td>
<td>27%</td>
</tr>
<tr>
<td>Analysts</td>
<td>22%</td>
</tr>
<tr>
<td>Employees</td>
<td>22%</td>
</tr>
<tr>
<td>Regulators</td>
<td>18%</td>
</tr>
<tr>
<td>Proxy advisory firms</td>
<td>15%</td>
</tr>
<tr>
<td>Media</td>
<td>8%</td>
</tr>
<tr>
<td>Retail shareholders</td>
<td>8%</td>
</tr>
</tbody>
</table>

Source: PwC’s 2012 Annual Corporate Directors Survey

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\(^9\) “Reg FD,” as it’s referred to, prohibits public companies from disclosing material nonpublic information to certain investors or stock market professionals, such as securities analysts, unless the information is also disseminated publicly.
Questions to consider:

- Should you have a policy on director-shareholder communications?
- How will you educate your directors, officers, and employees about Regulation Fair Disclosure?

Experienced directors know that, before even considering communicating with an investor, they need to coordinate messaging with the company and understand the implications of Regulation Fair Disclosure.
### A comparison of governance requirements between NYSE and NASDAQ

<table>
<thead>
<tr>
<th></th>
<th>NYSE</th>
<th>NASDAQ</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Director independence</strong></td>
<td>A majority of the board of directors must be independent.*</td>
<td>A majority of the board of directors must be independent.*</td>
</tr>
<tr>
<td><strong>Board committees</strong></td>
<td>A board must have audit, compensation, and nominating/governance committees. See Appendix C for committee requirements.</td>
<td>The board must have an audit committee and a compensation committee. It is not required to have a nominating committee; however, if it doesn’t, independent directors need to fulfill these responsibilities. See Appendix C for committee requirements.</td>
</tr>
<tr>
<td><strong>Executive sessions</strong></td>
<td>Nonmanagement directors must meet at regularly scheduled executive sessions without management. Independent directors should meet alone in executive session at least once per year.</td>
<td>Independent directors must have regularly scheduled executive sessions at which only independent directors are present.</td>
</tr>
<tr>
<td><strong>Corporate governance guidelines</strong></td>
<td>Companies must disclose corporate governance guidelines that address:</td>
<td>No requirement.</td>
</tr>
<tr>
<td></td>
<td>• Director qualification standards</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Director responsibilities</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Director access to management and independent advisors, if necessary</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Director compensation</td>
<td></td>
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<tr>
<td></td>
<td>• Director orientation and continuing education</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Management succession</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Annual evaluation of board performance</td>
<td></td>
</tr>
<tr>
<td><strong>CEO certification</strong></td>
<td>The CEO must certify annually that he or she is not aware of any violations of the NYSE corporate governance listing standards.</td>
<td>No requirement.</td>
</tr>
</tbody>
</table>

* See Section 2.6 for the exemptions for controlled companies.
Appendix B: Board-related proxy disclosures

The SEC requires a number of proxy disclosures that provide information about directors and board activities. This appendix describes many of these disclosures.

**Director-specific information**

For each continuing director and nominee:

- Name and age.
- Whether or not the individual is independent according to listing exchange requirements and what matters the board considered in determining that a director is independent. (See Section 2.2 for a discussion of director independence requirements.)
- Principal occupation and employment during the last five years. The name and principal business of any other company where the person had similar responsibilities. Whether any of the companies are/were a parent, subsidiary, or other affiliate of the company filing the proxy.
- Specific experience, background, attributes, or skills that qualify the person to be a director of the company.
- Nature of any family relationship between directors, nominees, and/or executive officers.
- Any other directorships held during the past five years.
- Involvement in certain legal proceedings during the past 10 years that are material to the evaluation of the ability and integrity of the director, such as bankruptcies, criminal proceedings, violations of securities laws, or sanctions.
- Current or past positions held with the company, and when held.

**Board-related information**

- The number of regular and special board meetings during the year.
- Whether directors attended at least 75% of board and committee meetings and names of any directors who did not.
- A description of the company’s policy (if there is one) on director attendance at the annual meeting.
- The number of directors who attended the prior year’s annual meeting.
- The compensation provided to each director, by category. (See Exhibit B.1 for required categories.)
Transactions exceeding $120,000 with a director where the company is a participant.

Whether the board has a process for shareholders to communicate with the board, and if not, why the board believes it’s appropriate not to have such a process.

### Exhibit B.1: Director compensation presentation template

<table>
<thead>
<tr>
<th>Name</th>
<th>Fees earned or paid in cash ($)</th>
<th>Stock awards ($)</th>
<th>Option awards ($)</th>
<th>Nonequity incentive plan compensation ($)</th>
<th>Change in pension value and nonqualified deferred compensation earnings ($)</th>
<th>All other compensation* ($)</th>
<th>Total ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td></td>
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</table>

* Includes perquisites, other personal benefits, tax gross-ups, discounted securities, consulting fees earned, director legacy programs and similar charitable award programs, life insurance premiums, dividends on stock option awards, etc.

### Committee-related information

- Whether each of the three major committees (audit, compensation, nominating/governance) has a charter and if it’s available on the company’s website. If it’s not available on the company’s website, include a copy of the charter in an appendix to the proxy statement at least every three years or if it has been materially amended in the past year.

- Whether any member of the compensation or nominating/governance committee is not independent.

- The name of the audit committee financial expert (if there is one) and whether this person is independent in accordance with audit committee independence rules. (See Exhibit B.2 for the definition of an audit committee financial expert.) Note that companies may name more than one director as an audit committee financial expert.

- If the board does not have nominating/governance or compensation committees (or committee(s) performing similar functions), disclose why the board does not have these committees and identify any directors who participate in director nominations and executive compensation discussions.
Oversight of risk

The company must discuss how the board oversees risk—whether through the full board, the audit committee, or another committee. Where relevant, companies may want to address whether individuals who supervise risks day-to-day report directly to the full board or a board committee.

Board leadership

The company must disclose whether the board has chosen to combine or separate the CEO and chair roles, and why it believes its leadership structure is the most appropriate one for the company at that time. The proxy should also discuss whether the board has a lead director and, if so, the role that person plays in board leadership.

Board diversity

The company must disclose whether, and how, the nominating/governance committee considers diversity in identifying board candidates. If there is a policy on board diversity, the company must discuss how the committee implements the policy and how it measures effectiveness. In practice, companies often describe a similar set of characteristics to define diversity, including gender, race, national origin, point of view, professional experience, education, and skills.

Exhibit B.2: Audit committee financial expert definition

The SEC defines an “audit committee financial expert” as a person who has the following attributes:

- An understanding of generally accepted accounting principles and financial statements;
- The ability to assess the general application of such principles in connection with the accounting for estimates, accruals, and reserves;
- Experience preparing, auditing, analyzing, or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the company’s financial statements, or experience actively supervising one or more persons engaged in such activities;
- An understanding of internal controls and procedures for financial reporting; and
- An understanding of audit committee functions.

Under the SEC’s rules, a person must have acquired such attributes through any one or more of the following:

- Education and experience as a principal financial officer, principal accounting officer, controller, public accountant or auditor, or experience in one or more positions that involve the performance of similar functions;
- Experience actively supervising a principal financial officer, principal accounting officer, controller, public accountant, auditor, or person performing similar functions;
- Experience overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing, or evaluation of financial statements; or
- Other relevant experience.
Appendix C: Specific committee requirements from the NYSE and NASDAQ

This appendix describes the SEC and the stock exchange requirements for the three major board-level committees. It also provides benchmarking information on committee size and meetings.

Audit committee

The audit committee’s key role is overseeing the reliability of financial reporting and related controls, including the relationship with the independent auditors. For more information, see Audit Committee Effectiveness—What Works Best, 4th edition, written by PwC and published by the Institute of Internal Auditors Research Foundation.

SEC requirements

- Be directly responsible for the appointment, compensation, retention, and oversight of the independent audit firm, including resolution of disagreements between management and the auditor regarding financial reporting
- Independent auditors report directly to the audit committee
- Establish procedures for: (i) the receipt, retention, and treatment of complaints received by the company regarding accounting, internal accounting controls, or auditing matters; and (ii) the confidential, anonymous submission by company employees of concerns regarding questionable accounting or auditing matters
- Have the authority to engage independent counsel and other advisors, as the committee determines necessary to carry out its duties
- Receive appropriate funding, as determined by the audit committee, to pay: (i) compensation to any auditing firm engaged, (ii) compensation to any advisors employed by the audit committee, and (iii) the committee’s ordinary administrative expenses that are necessary for it to carry out its duties
- Preapprove all audit and allowable non-audit services to be provided by the independent auditor
- The independent auditor must report to the audit committee on a timely basis: (a) all critical accounting policies used by the company, (b) alternative accounting treatments that have been discussed with management along with the potential ramifications of using those alternatives, and (c) other written communications provided by the auditor to management, including a schedule of unadjusted audit differences
• Disclose the name of at least one member who meets the SEC’s definition of an “audit committee financial expert” (see Exhibit B.2); if no one does, disclose why not.

• Include a report in the proxy outlining whether the audit committee has: (i) reviewed and discussed the company’s audited financial statements with management, (ii) discussed with the independent auditors the matters required to be discussed under PCAOB AU 380, and (iii) received from the auditors disclosures regarding the auditors’ independence required under PCAOB Ethics and Independence Rule 3526. Further, the report should include a statement by the audit committee whether, based on the review and discussions noted above, the audit committee recommends to the board of directors that the audited financial statements be included in the company’s annual report on Form 10-K or 10-KSB (as applicable) for filing with the SEC.

• Include the audit committee charter in the proxy at least once every three years or if major changes are made to the charter.

### Listing exchange requirements

<table>
<thead>
<tr>
<th></th>
<th>NYSE</th>
<th>NASDAQ</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Number of members</strong></td>
<td>At least three</td>
<td>At least three</td>
</tr>
<tr>
<td><strong>Number of meetings</strong></td>
<td>Does not specify a number of meetings. Listing rules call for the committee to meet and review the company’s annual audited financial statements and quarterly financial statements. This would suggest at least four meetings per year.</td>
<td>Does not specify a number of meetings</td>
</tr>
<tr>
<td><strong>Must be independent directors</strong></td>
<td>Yes, under both the NYSE’s listing standards and SEC Rule 10A-3</td>
<td>Yes, under both the NASDAQ’s listing standards and SEC Rule 10A-3; under exceptional and limited circumstances, may have one nonindependent director</td>
</tr>
<tr>
<td><strong>Requirements for financial knowledge</strong></td>
<td>All members are financially literate (or become so within a reasonable period after joining the committee), and at least one member has accounting or related financial management expertise</td>
<td>All are financially literate, and at least one member has experience in finance/accounting or certification in accounting that results in the individual having financial sophistication</td>
</tr>
<tr>
<td><strong>Other requirements</strong></td>
<td>No audit committee member may serve on the audit committee of more than three public companies unless the board determines that such simultaneous service and related time commitments don't impair the member’s ability to serve effectively on the company’s audit committee. If this exception is used, the board’s determination must be disclosed in the proxy.</td>
<td></td>
</tr>
<tr>
<td><strong>Written charter, reviewed annually</strong></td>
<td>Yes, and post on the company’s website</td>
<td>Yes</td>
</tr>
</tbody>
</table>
The listing exchanges also assign specific responsibilities to audit committees in addition to the SEC’s requirements. We observe that many NASDAQ companies voluntarily adopt many of the NYSE mandated committee responsibilities.

<table>
<thead>
<tr>
<th>NYSE</th>
<th>NASDAQ</th>
</tr>
</thead>
<tbody>
<tr>
<td>• At least annually, obtain and review a report by the independent auditor describing: the firm’s internal quality-control procedures; any material issues raised by the most recent internal quality control review, or peer review, of the firm, or by any inquiry or investigation by governmental or professional authorities, within the preceding five years, respecting one or more independent audits carried out by the firm, and any steps taken to deal with any such issues; and (to assess the auditor’s independence) all relationships between the auditor and the company</td>
<td>• Receive from the independent auditor a formal written statement delineating all relationships between the auditor and the company, actively engage in a dialogue with the auditor regarding any disclosed relationships or services that may impact the objectivity and independence of the auditor, and take, or recommend that the full board take, appropriate action to oversee the independence of the outside auditor</td>
</tr>
<tr>
<td>• Meet to review and discuss the company’s annual audited financial statements and quarterly financial statements with management and the independent auditor, including reviewing the company’s specific disclosures under “Management’s Discussion and Analysis of Financial Condition and Results of Operations”</td>
<td>• Oversee the company’s financial and accounting processes and the audits of the financial statements</td>
</tr>
<tr>
<td>• Discuss the company’s earnings press releases, as well as financial information and earnings guidance provided to analysts and rating agencies</td>
<td>• Review related party transactions</td>
</tr>
<tr>
<td>• Periodically, meet separately with management, with internal auditors (or others responsible for the internal audit function) and with the independent auditor</td>
<td>[Note: As at the time of this writing, NASDAQ has proposed rules to require listed companies to have an internal audit function. The proposal would require audit committees to meet periodically with internal audit and assist the board in overseeing internal audit’s performance. The proposal also advises audit committees to discuss internal audit’s responsibilities, budget, and staffing with the external auditors.]</td>
</tr>
<tr>
<td>• Set clear hiring policies for the employees or former employees of the independent audit firm</td>
<td>• Oversee the performance of the internal audit function [An internal audit function is required for companies listed on the NYSE]</td>
</tr>
<tr>
<td>• Review with the independent auditor any audit problems or difficulties and management’s response</td>
<td>• Assist the board in oversight of the company’s compliance with legal and regulatory requirements</td>
</tr>
<tr>
<td>• Periodically discuss with management policies relating to risk assessment and risk management</td>
<td>• Conduct an annual performance evaluation</td>
</tr>
<tr>
<td>• Oversee the performance of the internal audit function [An internal audit function is required for companies listed on the NYSE]</td>
<td>• Report regularly to the board</td>
</tr>
</tbody>
</table>

**Benchmarking the audit committee**

<table>
<thead>
<tr>
<th>NACD</th>
<th>The Conference Board</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of members</td>
<td>3.3–4.3</td>
</tr>
<tr>
<td>Number of meetings</td>
<td>8.5</td>
</tr>
<tr>
<td>Hours per in-person meeting</td>
<td>2.7</td>
</tr>
</tbody>
</table>

1 Depending on company size
**Compensation committee**

The compensation committee’s key role is to determine compensation for the CEO and other senior executives. In recent years there has been tremendous scrutiny of CEO compensation and, in particular, its link to company performance and risk taking. This has put compensation committees and the role compensation consultants play in the spotlight. The Dodd-Frank Act imposed additional independence requirements for compensation committee members and required committees to consider specific independence factors for their advisors.

**SEC requirements**

The following SEC rules for compensation committees are actually put into effect by the stock exchanges’ listing rules.

- Have sole discretion to retain or get advice from a compensation consultant, legal counsel, or other advisor
- Be directly responsible for appointing, compensating, and overseeing any compensation, legal, or other advisors used
- Receive appropriate funding from the company to pay reasonable compensation to the compensation consultant or other advisors retained by the committee
- Consider the following independence criteria before retaining any compensation consultant (or other advisor or outside legal counsel):

  1. What other services the firm that employs the compensation consultant provides to the company
  2. How significant the fees the company paid to the compensation consulting firm are, as a percentage of the total revenue of that firm
  3. What policies and procedures the compensation consulting firm has to prevent conflicts of interest
  4. Whether the compensation consultant has any business or personal relationships with a member of the compensation committee
  5. Whether the compensation consultant owns any company stock
  6. Whether the compensation consultant has any business or personal relationship with an executive officer of the company

[Note: A committee can retain a nonindependent compensation consultant, as long as it has considered all six independence factors. Additionally, the SEC rule makes it clear a compensation committee is not bound to implement the recommendations it receives from any advisor.]

Additionally, the SEC requires companies to disclose in the proxy the nature of any conflict of interest the compensation consultant has and how the conflict is being addressed.
Listing exchange requirements

The NYSE requires companies to have a compensation committee. In early 2013, NASDAQ adopted rules to require independent compensation committees for the first time, with some requirements taking effect by July 2013 and a phase-in period for other requirements, extending to the earlier of their first annual meeting after January 15, 2014, or October 31, 2014. (Previously, CEO compensation had to be determined by a majority of the independent directors of the board if there was no compensation committee.)

<table>
<thead>
<tr>
<th>Number of members</th>
<th>NYSE</th>
<th>NASDAQ</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Not specified</td>
<td>At least two</td>
</tr>
</tbody>
</table>

**Member independence**
- Must be composed entirely of directors who are independent under the NYSE’s general board independence standards. The board also has to consider whether the following would impair a director’s ability to make independent judgments about executive compensation:
  - The sources of compensation a director receives from a person or entity
  - Any affiliation a director has with the company, any of its subsidiaries, or any affiliate of a subsidiary that places a director under the direct or indirect control of the company or management, or creates a relationship with executives that would impair his or her judgment.

(These requirements are new and take effect in 2013 or 2014.)

**Number of meetings**
- Not specified

**Exemptions**
- Controlled companies and certain other listed companies specifically exempted by the exchange

**Written charter, reviewed annually**
- Yes, and post on the company’s website

<table>
<thead>
<tr>
<th>Number of meetings</th>
<th>NYSE</th>
<th>NASDAQ</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Not specified</td>
<td>Not specified</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Exemptions</th>
<th>NYSE</th>
<th>NASDAQ</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Controlled companies and certain other listed companies specifically exempted by the exchange</td>
<td>Controlled companies and certain other listed companies specifically exempted by the exchange</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Written charter, reviewed annually</th>
<th>NYSE</th>
<th>NASDAQ</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes, and post on the company’s website</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>
The listing exchanges also assign specific responsibilities to compensation committees in addition to the SEC requirements.

### NYSE
- Review and approve corporate goals and objectives relevant to CEO compensation, evaluate CEO performance, and determine CEO compensation level based on this evaluation
- Make recommendations to the board regarding the compensation of other executive officers, including any incentive and equity compensation plans that require board approval
- Conduct an annual performance evaluation

### NASDAQ
- Determine, or recommend to the board for determination, the compensation of the chief executive officer and all other executive officers in the company. Note that the CEO must not be present during any voting or deliberations on his or her compensation.

<table>
<thead>
<tr>
<th>Benchmarking the compensation committee</th>
<th>NACD</th>
<th>The Conference Board</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of members</td>
<td>3.4–4.2&lt;sup&gt;1&lt;/sup&gt;</td>
<td>4</td>
</tr>
<tr>
<td>Number of meetings</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Hours per in-person meeting</td>
<td>2.2</td>
<td>NA</td>
</tr>
</tbody>
</table>

<sup>1</sup> Depending on company size

### Nominating/governance committee
This committee takes the lead in identifying director candidates, recommending governance principles and practices, and organizing board and committee membership and evaluations. Many times, the lead or presiding director chairs this committee.

### Listing exchange requirements
NYSE requires a nominating/governance committee; NASDAQ does not.

<table>
<thead>
<tr>
<th></th>
<th>NYSE</th>
<th>NASDAQ</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of members</td>
<td>Not specified</td>
<td>Not specified</td>
</tr>
<tr>
<td>Member independence</td>
<td>Must be composed entirely of independent directors</td>
<td>Either have a nominations committee comprised solely of independent directors or have those responsibilities performed by a majority of the independent directors in a vote in which only independent directors participate</td>
</tr>
<tr>
<td>Number of meetings</td>
<td>Not specified</td>
<td>Not specified</td>
</tr>
<tr>
<td>Written charter</td>
<td>Yes, and post on the company’s website</td>
<td>Yes</td>
</tr>
</tbody>
</table>
The NYSE requires nominating/governance committees to:

- Identify individuals qualified to become board members consistent with the criteria approved by the board
- Take a leadership role in shaping the corporate governance of the corporation
- Evaluate their performance annually

<table>
<thead>
<tr>
<th>Benchmarking the nominating/governance committee</th>
<th>NACD</th>
<th>The Conference Board</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of members</td>
<td>3.3–4.4</td>
<td>4</td>
</tr>
<tr>
<td>Number of meetings</td>
<td>5</td>
<td>4</td>
</tr>
<tr>
<td>Hours per in-person meeting</td>
<td>1.7</td>
<td>NA</td>
</tr>
</tbody>
</table>

1 Depending on company size
Appendix D: Overview of the IPO process

Taking a company public can be a challenging and lengthy process. Depending on how sophisticated a company’s processes and organization structure are, the going public process can take from a number of months to a year or longer. This appendix describes the extent of work involved in the transition, up to the point where the company’s registration statement is declared effective by the SEC.

1. Prepare the company for the IPO

Preparing to go public involves coordinating among a number of different functions within the company, as shown in Exhibit D.1. There is an added burden on senior executives, who must focus on simultaneously running the business and making key IPO decisions.

Exhibit D.1—Framework to assess IPO readiness

<table>
<thead>
<tr>
<th>Corporate strategy and development</th>
<th>Accounting reporting and financial effectiveness</th>
<th>Governance and leadership</th>
<th>Internal controls</th>
<th>Media and investor relations</th>
<th>Treasury and financial risk management</th>
<th>Legal</th>
<th>Tax</th>
<th>HR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Technology</td>
<td></td>
<td>Project management, change management, and communications</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

A company may find multiple changes are needed in most, if not all, of these functions. For example, from a human resources perspective, a company needs qualified finance, legal, and other skilled personnel to handle the extensive information and reporting aspects of being a public company. It also needs competent people to lead other key functions, such as marketing, operations, and investor relations. Companies have to describe the backgrounds of key executives in the registration statement, so those executives’ stated qualifications will be subject to scrutiny.

Interview insights

We didn’t really have a legal department. Our general counsel was just focusing on customer contracts.

—Director

As well as making personnel decisions, many companies need to upgrade business processes, particularly around financial reporting and compliance. Among the key items companies and directors should understand:

- What company and business information they need to update or create for their registration statement
• Whether they have an adequate history of audited financial statements, performed by an audit firm the underwriters and potential investors will accept. Going public requires three years of audited financial statements (or two years if filing as an emerging growth company (EGC) under the JOBS Act). If the company doesn't have a history of annual audits, it can face an expensive and time-consuming process to have prior financial statements audited. Companies might also engage an accounting firm to help analyze accounting and reporting readiness and to prepare for questions from the SEC’s review of the registration statement.

• What changes may be needed to board composition or governance policies, including recruiting new directors, establishing committees, and even possibly amending bylaws

• Whether current outside counsel has experience with IPOs or the company needs to engage a different law firm

• Which underwriter to engage. Underwriters are typically major investment banks that act as the company’s agent in offering securities to the public. The lead underwriter is responsible for pricing, selling, and organizing the IPO.

2. Draft and submit the initial registration statement

The lead underwriter coordinates an initial organization meeting with management, the independent auditor, accounting advisors, any other underwriters, and attorneys for both the company and the underwriters. The discussion covers the nature of the offering, coordinates responsibilities for drafting the registration statement, establishes a timetable, and shares other pertinent information.

Similar meetings are held throughout the process to discuss issues, review drafts, and monitor the timetable. The lead underwriter and its attorneys also start their due diligence on the company and management, and on the registration statement as it is prepared.

The registration statement (Form S-1) is a comprehensive document that includes the prospectus as well as additional information. The prospectus must contain a number of items, including information about:

• The business
• The risks the company faces
• Executive and director biographies
• Financial information, including audited financial statements and, if required, pro forma financial statements

*Interview insights*

In my experience, the biggest challenge is getting the financial statements done to SEC standards. It’s important and it takes a lot of time to fix.

—Director

We had public debt, and so we were already filing financials quarterly and annually with the SEC. Still, we had a lot of work to address governance issues and get internal controls, internal audit, and finance resources up to speed.

—Executive
• Information about the board and its committees
• Executive and director compensation
• The stock being offered for sale—including expected number of shares, dividend policy, listing exchange, and how the company plans to use the proceeds from the offering
• Underwriting and distribution of securities

The prospectus also includes management discussion and analysis (MD&A). MD&A provides investors with information on the company’s financial condition, results of operations, liquidity, and capital resources, as well as management’s comments on known trends and uncertainties. (In our experience, this forward-looking information can be the most difficult section for management to write, and it’s often the focus of SEC comments.)

Different companies have different experiences with how long it takes to draft and submit their initial S-1, with the time frame ranging from one to three months or more.

Although rare, a company might choose to have a prefiling conference with the SEC. This is an opportunity for the company to discuss a particularly complex accounting or legal issue and resolve it prior to the filing.

The JOBS Act allows EGCs to make their initial submission of their S-1 with the SEC on a confidential basis. This is helpful because it allows an EGC to keep information—about markets, its business plans, risks, and key performance metrics—confidential for a longer period of time.
3. **Update and finalize the registration statement**

Management needs to amend the initial registration statement to:

- Address the SEC’s comments
- Update or revise information previously provided, including financial information and any changes to governance practices
- Include any new directors added to the company’s board, or name those who will be added once the securities offered in the registration statement are sold

Interview insights

Managers need to understand that what they’re experiencing [when going public] is not an unusual level of scrutiny, and they shouldn’t pick a fight with regulators, even though it can be extremely frustrating.

—Director

It’s not unusual for companies to receive dozens of SEC comments about the registration statement and to have to amend it several times. Depending on the number of rounds of comments back and forth, this process may take a number of months.

During this time, directors and officers must confirm that information in the registration statement is accurate. Attorneys for both the company and the underwriter will deliver a “negative assurance letter.” These letters state that nothing has come to their attention to cause them to believe the registration statement contained a material untrue statement or left out a material fact that needed to be there to ensure the registration statement wasn’t misleading.

The independent auditor issues a “comfort letter,” typically covering information derived from accounting records that is subject to the company’s internal control over financial reporting. Comfort letters are usually issued to the underwriters when the underwriting agreement is signed (generally the pricing date), with an updated letter at the closing date. The independent auditor also performs “keeping current” procedures on the company’s financial statements through the effective date of the registration statement.

What’s next? Completing the transition to “Being Public.”
Appendix E: Research methodology

PwC performed original research and reviewed existing surveys of governance practices. Additionally, we conducted interviews to discuss governance at IPO companies and drew on the knowledge and experience of PwC professionals who work with companies going public.

PwC’s IPO Study

To determine how companies’ governance policies and practices evolve before and after their IPO, we selected 50 companies that had their IPO in 2009 or 2010. We examined their governance structures in their initial S-1, their final S-1, and their 2012 proxy.

We started with the 50 largest IPOs, based on the size of the offering noted in the final S-1. (Note, this is not necessarily the amount actually raised through the offering.) We then eliminated 19 companies including:

- General Motors Company, because the nature of its IPO was atypical and the size of its offering (at more than $15 billion) far exceeded other companies.
- Those that were no longer publicly traded at the time of our research—either because they were acquired by another company, went private, or filed for bankruptcy protection.
- REITs that were holding companies only and had outsourced management.

When we dropped companies, we then selected the next largest companies that met our criteria.

The companies ultimately included in our study are from a variety of industries: financial services, healthcare, consumer products, industrial products, real estate, energy, and technology. The offering sizes varied, as summarized below:

<table>
<thead>
<tr>
<th>Size of offering</th>
<th>Number of companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $250 million</td>
<td>24</td>
</tr>
<tr>
<td>$250 million to $500 million</td>
<td>15</td>
</tr>
<tr>
<td>$500 million to $750 million</td>
<td>7</td>
</tr>
<tr>
<td>Greater than $750 million</td>
<td>4</td>
</tr>
</tbody>
</table>

Of the 50 companies in our sample, 19 (or 38%) were controlled companies and 31 (62%) were noncontrolled at the time of their final S-1. Twelve of these companies remained controlled companies when they issued their 2012 proxy statements.
Interview activities

We conducted interviews with 13 directors, executives, legal advisors, and individuals from the investor community. These interviews allowed us to understand their “going public” experience and their views about boards and governance in the IPO context, and we thank them.

Among the individuals who gave their time and shared their experience, expertise, and perspectives are:

Thomas J. Barry

Christopher Birosak, Managing Partner, North Cove Partners LLC

J. Frank Brown, Managing Director & COO, General Atlantic and Director, Home Depot

Stephen L. Brown, Senior Director of Corporate Governance & Associate General Counsel, TIAA-CREF

Brad Buss, Director, Tesla Motors and Cafepress.com

Robert B. Lamm, Securities and Corporate Governance Counsel; most recently Assistant General Counsel and Assistant Secretary, Pfizer Inc.; Chair, Securities Law Committee, Society of Corporate Secretaries and Governance Professionals

Brenda L. Morris, CFO, 5.11 Tactical Inc.

Marco Romero, CEO, Delta Gold Corporation

Yancey Spruill, EVP and Chief Financial Officer, DigitalGlobe

Eric S. Whitaker, Senior Vice President & Chief Legal Officer, SanDisk

Ann Yerger, Executive Director, Council of Institutional Investors
Many sources provide useful information for directors and management on going public. These range from organizations that supply benchmarking information to educational groups.

Such information is important for the various parties involved, whether used for making decisions, understanding regulatory requirements, or getting insight into how the IPO process works.

We’ve prepared a list of resources you may find useful as you focus on the governance aspects of your IPO.

In addition to outlining PwC’s thought leadership, we list resources in the following categories: benchmarking data, governance influencers, law firms, regulators and stock exchanges, director-focused media, and educational venues. In some cases, we’ve included links to educational events such as conferences, seminars, and courses.

Citations for benchmarking statistics provided throughout the publication

Many organizations survey directors or analyze proxies to track current board structures and practices. Below is a list of the surveys and organizations we cited.

**National Association of Corporate Directors**—2012-2013 Public Company Governance Survey

**Spencer Stuart**—2012 Board Index

Additional benchmarking surveys you may wish to reference

The Conference Board—Proxy Voting Fact Sheet (three times a year) www.conference-board.org/publications/publicationdetail.cfm?publicationid=2163


Governance influencers

These are many influential groups in the corporate governance and shareholder communities. They include proxy advisors, institutional investors, and ratings organizations. Many shareholders look to these organizations for advice on proxy voting.

Institutional Shareholder Services (ISS) www.issgovernance.com/
Glass Lewis www.glasslewis.com/
CalPERS www.calpers.ca.gov/
CalSTRS www.calstrs.com/
TIAA-CREF www.tiaa-cref.org/
The Corporate Library, which provides Governance Metrics International Ratings www.gmiratings.com
Council of Institutional Investors www.cii.org/

Legal publications

Major law firms offer analysis and advice on important corporate governance issues. Here is a partial list of these firms and the publications they provide.

Davis Polk—Corporate Governance Practices of US Initial Public Offerings
Latham & Watkins—Giving Good Guidance: What Every Public Company Should Know
Weil, Gotshal & Manges—Comparison of Corporate Governance Guidelines and Codes of Best Practice
Wilson Sonsini Goodrich & Rosati—Corporate Governance and Disclosure Practices of Venture-Backed Companies in US Initial Public Offerings
Regulators and stock exchanges

The listing exchanges and the SEC have rules that govern the disclosure requirements of public companies. There are other regulators, such as the Public Company Accounting Oversight Board, that impact various board committees.


**SEC**—especially the 1933 and 1934 Acts  [www.sec.gov](http://www.sec.gov)

**PCAOB**—Standards that govern the audits of public companies  [www.pcaobus.org/](http://www.pcaobus.org/)

Director-focused media

Many print and online publications cover corporate governance.

**NACD Directorship**  [www.nacdonline.org](http://www.nacdonline.org)

**Corporate Board Member**  [www.boardmember.com](http://www.boardmember.com)

**Agenda**  [www.agendaweek.com](http://www.agendaweek.com)

**The Corporate Board**  [www.corporateboard.com/](http://www.corporateboard.com/)

**Directors and Boards**  [www.directorsandboards.com/](http://www.directorsandboards.com/)

**Pensions & Investments**  [www.pionline.com](http://www.pionline.com)

Educational venues

There are numerous opportunities for directors to get education, including seminars and university-based programs.

**National Association of Corporate Directors**—Annual Conference, Director Professionalism courses, local chapter events  [www.nacdonline.org/Events](http://www.nacdonline.org/Events)

**Corporate Board Member**—Boardroom Summit, Risk Conference  [www.boardmember.com/conference/aspx](http://www.boardmember.com/conference/aspx)

**The Rock Center of Stanford Law School**—Directors’ College  [www.rockcenter.law.stanford.edu/list/events](http://www.rockcenter.law.stanford.edu/list/events)

**Ira M. Millstein Center for Global Markets and Corporate Ownership at Columbia Law School**  [http://web.law.columbia.edu/millsteincenter](http://web.law.columbia.edu/millsteincenter)

**The Conference Board**—The Governance Center  [www.conference-board.org/governance](http://www.conference-board.org/governance)

Appendix G: Summary of questions to consider

G.1 Understanding IPOs and directors’ roles

1. Origins of IPOs
   - Will you be a controlled company after your IPO? If so, is the control based on voting rights, and what are the implications?

2. Impact of the JOBS Act
   - Does your company qualify to be classified as an emerging growth company (EGC)?
   - How might potential investors view the attractiveness of your shares or the risks of investing in your company, if you provide the reduced level of disclosures allowed as an EGC?
   - If you are an EGC, are you planning to voluntarily adopt any of the accounting, auditing, or disclosure provisions beyond what would be required? If so, which ones and why?

G.2 Building your board

1. Board size
   - What is the ideal size for your board now? When you go public? Once you are public?
   - How many directors do you need to recruit? (The independence requirements may factor into answering this question.)

2. Board and director independence
   - Which stock exchange independence rules will apply to you?
   - How many of your directors are currently independent?
   - What shifts in board composition do you need to make to have a majority independent board? When do you need to do this?
3. Board composition and director recruitment
   • Are there any “must-have” attributes you need to consider in prospective directors?
   • Do you anticipate any difficulties in attracting the type of director candidates you need?
   • How will your shareholders view your board’s overall composition, including breadth of expertise and diversity?
   • What types of personality attributes will help a director be effective on your board?
   • What is the optimal time to identify and add new directors?

4. Board committees
   • If you don’t currently have an audit, compensation, or nominating/governance committee comprising independent directors, do you need to add a committee or change membership?
   • To what extent do you need committees other than the three major ones?
   • Do you need to create or revise committee charters?
   • How effective is the information flow between individual committees and the full board?

5. Transition timeline
   • What, if anything, do you need to do to comply with the exchange’s governance requirements? What is your deadline for compliance?

6. Controlled companies
   • If you are a controlled company when you go public, do you plan to use any or all of the independence exemptions available?
   • If you are a controlled company when you go public, do you anticipate a change in that status? If so, what are the timing and impact?
   • Might taking advantage of any controlled company exemptions impact the marketing of your stock?

7. Board leadership: split or combined chair and CEO
   • If you combine the CEO and board chair roles pre-IPO, do you expect pressure to separate the roles after becoming a public company? If so, how would you respond?
   • Which director inspires the confidence to provide independent board leadership as either lead director or chair?

8. Director terms: annual or multiyear
   • Will the frequency you use to elect directors still work for the company after going public?
   • What frequency of director elections do your major shareholders prefer?
9. Director tenure
   • Should you consider any policies on director tenure, such as an age or term limit?

10. Scheduling meetings
   • Will your board need to meet more or less frequently once you become a public company?
   • What factors may influence the timing and location of your meetings?
   • Would it work better for you to schedule committee meetings concurrently or consecutively?

11. Director compensation
   • What information do you need to determine the appropriate level of compensation to pay your directors?
   • Do you have the right mix of director compensation to align directors’ interests with those of shareholders?
   • Should you set minimum stock ownership requirements for directors?

G.3 Understanding key governance influences

1. Investor profile
   • What is the anticipated ownership mix (founders, company executives and employees, institutional, private equity, retail, etc.) in the company’s shareholder base?
   • Might your anticipated shareholders have concerns about your governance practices that could make you a likely target for shareholder activism or proposals?
   • How are you planning to handle investor relations, and are you satisfied with your strategy to build relationships with proxy advisory firms and shareholders?
   • Should you build any antitakeover defenses into your organizational and corporate governance documents before you go public?

2. Shareholder voting
   • What are the advantages of adopting majority versus plurality voting at this stage?
3. Proxy advisory firms

- How do your governance policies compare to the voting policies of the proxy advisory firms and the major investors you want to attract?
- At what point might you need a plan to deal with possible negative voting recommendations or “withhold” vote campaigns against directors?

4. Changes to broker voting rules

- What impact do you think the broker nonvote rules will have on your proxy voting results?

G.4 Protecting directors

1. Fiduciary duties

- Is your board’s decision-making process thorough, appropriately documented, and in the best interests of your company and its shareholders?
- Does your board get the information it needs from management to make sound decisions? Does it use outside advisors when needed?
- Are you staying current on court decisions that can affect fiduciary duties or the protections of the business judgment rule?
- Do you understand to whom you owe fiduciary duties?

2. Director protection measures

- Does your board fully understand how directors are covered under the company’s indemnification and D&O insurance?
- Are you comfortable with the level of D&O coverage?

3. Director orientation

- Is there a robust director orientation to maximize director and board effectiveness?
- Do you provide opportunities for new directors to meet with other directors on the board as part of their acclimation?
G.5 | Preparing for the first year out

1. Proxy statement
   - Do you understand the full scope of information you need to report?
   - Do you have the right resources in place to compile the proxy?
   - Do you have a strategy for drafting the proxy in a way that’s consistent with the company’s shareholder communications strategy?

2. Proxy solicitors
   - Do you need a proxy solicitation firm, and if so, what should the nature of the relationship be?
   - Do you need a strategy to encourage your retail shareholders to vote?

3. Annual meeting of shareholders
   - Do you have the right resources involved in planning the annual meeting and a comprehensive plan to address all needed elements?
   - Do you anticipate any disruptive behavior at your annual meeting?

4. Director-shareholder communications
   - Should you have a policy on director-shareholder communications?
   - How will you educate your directors, officers, and employees about Regulation Fair Disclosure?
PwC’s What Works Best™ publications

Board Effectiveness—What Works Best, 2nd Edition
This book shows directors how they can most effectively carry out their role as a board member—from overseeing strategy to setting CEO compensation. It includes insights from their peers and PwC professionals.

Audit Committee Effectiveness—What Works Best, 4th Edition
Demands and expectations on the audit committee keep increasing, and its role in the capital markets is vital. This guide helps audit committee members best fulfill their considerable and important responsibilities.

Governance for Companies Going Public—What Works Best™
This book describes key governance decisions that companies need to make before and after an initial public offering (IPO) and includes insights from directors, executives, advisors, and the investor community. Among other topics, it discusses building the board and understanding the myriad governance influences.

Directors and IT—What Works Best™
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Directors and IT—What Works Best™, Abridged version
This publication offers a summary of the unabridged version of the board guide for effective IT oversight. It highlights our suggested approach for directors to best fulfill their IT oversight responsibility.

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