Russell Reynolds Associates

Assembling the Pre-IPO Board Puzzle:

How to Structure an Effective Pre-IPO Board (in the UK)

Preparing for an IPO is a challenging task. Multiple stakeholder interests, severe time constraints and other constantly moving parts makes for a highly complex and delicate process. But of the multiple, concurrent processes and preparations needed, one of, if not the most, important aspects of planning a successful IPO is a well-constructed board.

A well-constructed board lays the foundations for good governance through the IPO journey, provides support and guidance to the management team in delivering the company strategy and satisfies shareholder requirements. Perhaps most importantly, a well-constructed pre-IPO board is a key driver of enhancing the company's valuation. Firms should consider their board builds early in order to enhance the chances of attracting the best candidates and ensure that the board not only satisfies the demands of the listing regime and potential shareholders, but also adds to the asset's valuation. Requirements around the world will differ, but the core principles remain the same: careful preparation and planning, stakeholder alignment and value creation, all the while ensuring compliance with relevant listing requirements.

Russell Reynolds Associates has an extensive track record in supporting and advising on building boards for IPO, including helping private capital firms prepare portfolio companies for listing on indices around the world. In the first of a Russell Reynolds thought leadership series on building pre-IPO boards, we focus our attention in this edition on our extensive experience in building pre-IPO boards in the UK, with future issues highlighting our learnings and recommendations in other parts of the world.

Based on this experience, and supplemented with our analysis of companies that listed on the London Stock Exchange between 2018 - 2021 (n=54), we identified the key components for delivering a successful, timely and value-enhancing board.

Laying the foundations

Building a pre-IPO board can be seen as analogous to assembling a jigsaw puzzle. It requires an appreciation of the whole picture and an understanding of how to piece each component together. Some of these 'puzzle pieces' are determined by listing requirements and corporate governance guidelines, for example, the appointment of an independent chair or the requirement for gender or ethnic diversity, but each company will also have a range of business, market or sector-specific requirements that will necessitate specific skills and experience. To ensure all the pieces of the puzzle form a cohesive and complementary whole, shareholders need to simultaneously evaluate multiple candidates in a short amount of time against a diverse range of criteria - all the while adhering to a rigorous process and advancing towards the IPO deadline.

Creating value with the right board

Every pre-IPO board build will differ, but there are certain key elements that need to be addressed in all situations—listing rules, corporate governance best practices and, most importantly, the commercial and strategic needs of the business. At times, these might be seen as contradictory. Private capital investors and entrepreneurial management teams frequently emphasise the importance of maintaining a nimble culture and a focus on value-creation, and smaller companies often fear the impact of an influx of governance-oriented NEDs. Properly composed, the right board will have skills and experience that both align with the commercial strategy of the company and fulfil the governance criteria, enabling it to guide the organisation through a period of significant change and sustained success as a listed business.

Comply or explain? Demonstrating a pathway to meeting governance requirements

While UK governance allows boards to "comply or explain," too much "explaining" can detract from the IPO equity story, so while not all premium listed companies are fully compliant with governance expectations at the date of IPO, the majority do demonstrate a pathway to compliance and best practice.

Our analysis of companies that listed on the LSE (2018-2021, n=54) against five key UK corporate governance requirements, provide evidence to support this as detailed in the table below. Shareholder directors' continued presence on boards creates a particular challenge in achieving a board with a majority of independent directors, however most newly listed companies will reduce the number of shareholder directors on the board over time. Continuity of board leadership is valued highly, contributing to the relatively low proportion of companies that meet the requirement for an independent Chair at the point of IPO.

Comparison: Key governance requirements

Criteria	Newly listed companies (RRA analysis of LSE listings 2018-2021, n-54)	FTSE 350 (As of 07/2022)
Independent Chair	39%	93%
Majority of independent directors	24%	99%
Diversity targets met	92%	84%
Remuneration Chair with 12 months experience	58%	75%
Audit Chair fully qualified	80%	87%

Source: RRA's London Stock Exchange Board & Governance Analysis (2018-2021, n=54)

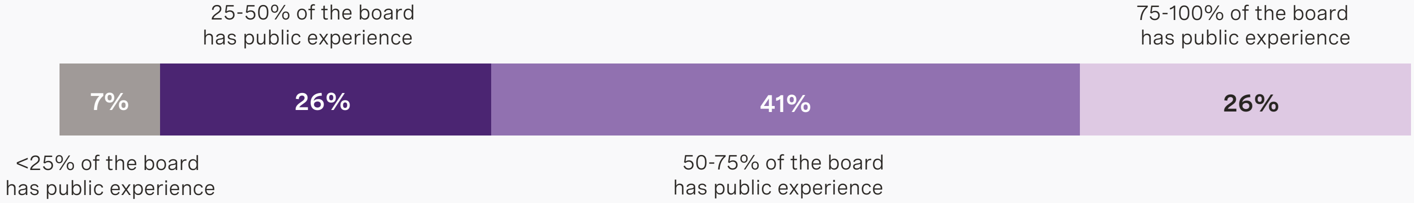
Prioritising keystone appointments

In most board builds, the chair, senior independent director (SID) and committee chairs are the priority roles which will need to be addressed first. The chair 'sets the tone from the top' playing a key role in composing the rest of the board, attracting the best talent and helping to communicate the business' IPO story. In some cases, a suitably experienced and sufficiently independent chair who can lead the business through the IPO may already be in place. If this is the case, the SID and committee chair roles become the highest priority. If the chair is not deemed independent, the appointment of a suitable SID becomes even more critical, with a particular focus on public market credentials. [Refer to page 5 for more detail on keystone roles.]

With the anchor role(s) confirmed, the next step in the process is determining how the rest of the board will be built out. Whilst it is important to carefully balance the skills and experience each director brings, time constraints often make it difficult to appoint board directors sequentially. In our experience, pre-IPO boards are usually best built 'in parallel', with the various pieces assembled much like a jigsaw and repositioned and reshaped as candidates emerge. This approach not only allows for greater flexibility, but also ensures that criteria do not 'pile up' over time, creating unrealistic requirements in the final appointment.

Prior experience in a publicly listed entity is a common requirement for additional board members, as this is often a gap for entrepreneurial founders and leaders of companies with their sights set on an IPO. Unsurprisingly, the majority of boards have ensured that more than half of their board directors (at the point of listing) bring public markets experience (Figure 1).

Percentage of non-executive directors with public-listed company experience in companies newly listed on the LSE (2018-21, n=54)



Russell Reynolds Associates proprietary analysis of the boards of 54 organisations that listed on the LSE between 2018-21

Keystone appointments: SIDs & Committee Chairs

Following the appointment of the chair, the SID and committee chairs become the main priority. These roles are likely to have stricter requirements in terms of business and technical experience and will come under greater scrutiny by external stakeholders. Careful consideration will need to be given to the pool of candidates available to fill them.

Senior Independent Director

There are no formal background requirements to be a Senior Independent Director. However, SIDs will typically have substantial experience as a C-suite executive in a public listed company, will have proven City credentials and have demonstrated an ability to build strong relationships with shareholders.

Combining the SID role with either the Audit or RemCo chair role is a move often adopted in FTSE 250-sized companies. The combination of the SID with one of the committee chair roles does occur in the FTSE 100, but to a lesser extent, given the higher degree of responsibility these roles tend to entail in larger businesses.

Audit Chair

The FRC's UK corporate governance code states that members of the Audit committee should have "recent and relevant financial experience." In FTSE 350 companies, this will usually translate to an Audit Chair with experience as a CFO and/or a relevant financial qualification.

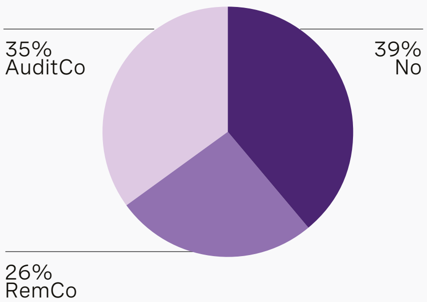
Most Audit Chairs bring both CFO experience and accounting qualifications (ACA, CIMA or equivalent). Those without a CFO background or accounting qualifications bring other financial experience that qualifies them to be an Audit Committee Chair.

RemCo Chair

The UK corporate governance code suggests that the chair of the Remuneration committee should have at least 12 months of experience serving on a Remuneration committee.

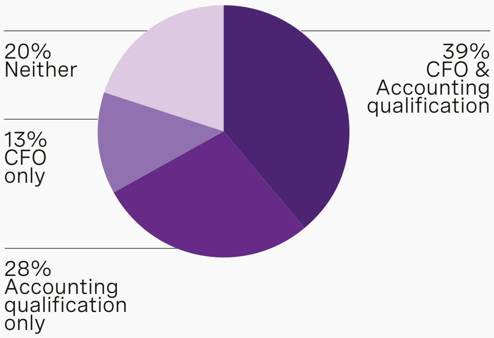
Boards with RemCo chairs who lack the requisite experience will need to justify their decision. "Unproven" RemCo Chairs typically bring remuneration knowledge via their executive general management or human resources experience, or have a strong understanding of the investor and stakeholder environment through other relevant experience.

Was the Senior Independent Director role combined with one of the committee chairs?



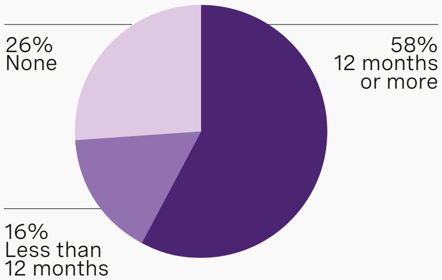
Source: Russell Reynolds Associates proprietary analysis of 31 SIDs at organisations that IPO'd on the LSE

How is the audit chair qualified?



Source: Russell Reynolds Associates proprietary analysis of 46 Audit Chairs at organisations that IPO'd on the LSE

Did the Renumeration Chair have 12 months of public Remuneration committee experience?



Source: Russell Reynolds Associates proprietary analysis of 43 RemCo Chairs at organisations that IPO'd on the

Ensuring a positive outcome: best practices and stakeholder engagement

Establishing alignment

The fast-paced nature of the IPO market often necessitates a speedy turnaround. Best-in-class board builds are achieved when investors, existing board members and management (particularly CEO, CFO, CHRO and chair) and search firm are fully are aligned on objectives and actively engaged in the process. Communication is key, and regular well-attended calls and discussions throughout the process are critical. Multiple stakeholders bringing different perspectives can present a challenge. It is vital therefore, to build trust and confidence from the outset, and to maintain frequent dialogue (every day, if needed!) to ensure alignment throughout the process.

Planning ahead

One of the most commonly cited reasons for failed (or poorly performing) IPOs is a lack of time. In terms of building the board, an overly short timeframe will limit the candidate pool to those with immediate availability and rule out candidates who require time to do sufficient due diligence and get comfortable putting their name to the prospectus. Engaging with an external advisor to start developing a plan as early as possible will help mitigate time constraints when an opportunity to list arises. Having a clear sense of the likely timeline to IPO and working backward to determine when the board build should commence will improve the overall quality of board appointments.

Stakeholder engagement

It is critical that all stakeholders demonstrate engagement, responsiveness and flexibility, and the wisdom and pragmatism to prioritise requirements. The external advisor plays a key role in coordinating activity and communication, particularly when there are multiple shareholders and no chair yet in place. Primary stakeholders vary in each process. While preferable to have the full range of stakeholders - from investors to current board members and company leadership - fully involved, this is not always possible. Management, for example, will often be heavily involved in other aspects of preparation for the IPO, while the extent to which investors will drive decision-making will vary. Some individual stakeholders may be involved in specific appointments: for example, a CFO will ideally be involved in an audit chair's appointment, and the CEO in the appointment of a chair.

Candidate engagement

Candidate pools for pre-IPO roles are limited. With tight deadlines and multiple processes running in parallel, a lot can go wrong. It is important to make sure candidates are properly engaged, available, and can commit to a fast-moving, often tense process.

Candidates also need to have genuine capacity to undertake all necessary pre-work, as well as a strong interest to join the board. Some appetite for risk and comfort with ambiguity is essential; exit plans may change, the identity of other board members may not be known, due diligence packs may be incomplete. External advisors play a critical role by creating as much transparency as possible and staying in close contact with potential new board member.

The appeal for candidates - Remuneration and time considerations

Candidates are frequently attracted by the opportunity to join a pre-IPO board. However, increasing restrictions on investment opportunities in the immediate pre-IPO phase mean that significant financial upside is unlikely for independent non-executive directors.

There can be tensions when existing board members stand to make significant upside while newly appointed directors—bearing equal workload through an intense IPO preparation phase or lending their name and profile to the process—receive a modest fee. Nonetheless, most independent director candidates still appreciate the opportunity to join the board with enough time to learn the business and to be involved in the excitement of preparing for an IPO.

Timing:

Equity options and compensation depend on how far in advance of the IPO the individual joins the board. In many cases, the timeline will be too close to the IPO to allow for any IPO-related bonus, share options, equity or success fees. There are a few alternatives to consider, such as paying an additional flat fee for time and effort invested or compensating new members who join six months before the IPO. Where organisations are following a dual-track process, fees may differ depending on the eventual outcome.

Role:

Candidates for the chair, audit and remuneration committee chair roles are particularly conscious of the significant time and effort required for IPO preparations. The board chair is most likely to receive equity because they are usually the first to be appointed, thus spending more time on the board during the pre-IPO process. The audit chair may expect to receive additional compensation beyond the basic director fee, as they bring crucial financial expertise, but the responsibility is fairly straightforward and does not drastically change as the organisation transitions from the private to public context. The remuneration chair may also expect to receive additional compensation, as their work is most challenging throughout the IPO process. This individual will lead a significant mindset shift, transitioning the executive team from equity-heavy compensation to a publicly compliant structure.

External perspectives: creating an effective board culture

Defining the necessary roles, skills and experience is key to optimising board composition, but making that board truly effective requires good leadership and a healthy culture. Working together with the chair and CEO, who ‘set the tone from the top’, careful attention must be paid to new cultural nuances that will inevitably emerge as the board evolves and moves through the IPO process.

Board dynamics will change as new directors are appointed. Shareholder representatives accustomed to high levels of control must accommodate external independent directors with different perspectives and responsibilities. Newly appointed directors, particularly those who join well in advance of an IPO, must recognise and balance the requirements of the current owners, future investors and wider stakeholders. Ensuring alignment across this range of stakeholders is a complex and multi-faceted and requires a deft touch. In many cases, the existing board, key stakeholders and candidates will not all be familiar with each other, and here an external advisor who does know all parties can be invaluable.

Setting realistic expectations: ambition and pragmatism

Owners and advisors are inherently ambitious regarding valuation—this is often reflected in a desire for high profile board members. The right board will help generate positive market response, but the board must also be appropriate for the company over the longer term. Early conversations about expectations and an unpacking of true business needs, combined with guidance on the dynamics of the talent pool will help focus the search for the best and most appropriate board members.

Completing the jigsaw puzzle

As with a jigsaw puzzle, the complexity and the time taken to assemble the right board will depend on the number of pieces in play. The greater the clarity on the overall picture and the component parts, the easier it will be to assemble. Time taken to prepare, understand the process and timing, align expectations, debate the priorities and define key appointments, and establish stakeholder engagement and communication is time well spent. Balancing the intermediary steps while keeping sight of the longer term requirements and the bigger picture requires effort. The resulting well-constructed board will support the IPO equity story and be a critical factor in the success of a newly public company.

Key contacts

Helen Metcalfe is a senior member of the firm's board & CEO Advisory Partners, specialising in chair, chief executive and non-executive director appointments and board advisory work.

Emily Taylor co-leads the global Private Equity Practice for Russell Reynolds Associates, working closely with investment teams, advising on chair and board appointments.

Laura Sanderson leads Russell Reynolds Associates' operations in the UK and oversees the firm's board & CEO Advisory Partners team throughout Europe.

Julia Budd is a senior member of the firm's board & CEO Advisory Partners, specialising in chair, CEO and non-executive director searches, as well as board succession planning. Julia advises clients across industries, from FTSE 100 boards to smaller companies which are, or are poised to become, leaders in their own markets.

Rhys Grossman co-leads the Consumer Sector and Consumer Digital & Media Practice for Russell Reynolds Associates, working closely with publicly listed, private equity and venture capital firms to recruit transformative leaders who understand the confluence of technology and business to spur future growth.

Luke Meynell co-leads the firm's board & CEO Advisory Partners, as well as leading the practice in the UK. He specializes in working with FTSE clients or equivalent organizations to deliver complex chief executive and chair succession projects, as well as other key board appointments, such as non-executive director or CFO roles. Luke is based in London.

Agnes Greaves co-leads the firm's Core & Growth Technology practice globally and the Consumer Digital & Media practice in Europe. She focuses on board and senior management appointments, advising both established market leaders and investor-backed clients on optimal organisational design and how to attract and retain high-impact and transformative leaders.

Emma Combe is a member of the firm's board & CEO Advisory Partners Sector. Based in London, Emma excels at identifying board chairs, CEOs, and executive and non-executive directors for listed, private equity and family-owned businesses.

Emily O'Shea specialises in chair, CEO and non-executive director appointments across a range of industries with a particular focus on healthcare, life sciences and organizations underpinned by innovation and R&D.

About Russell Reynolds Associates

Russell Reynolds Associates is a global leadership advisory firm. Our 520+ consultants in 47 offices work with public, private and nonprofit organisations across all industries and regions. We help our clients build teams of transformational leaders who can meet today's challenges and anticipate the digital, economic and political trends that are reshaping the global business environment. From helping boards with their structure, culture and effectiveness to identifying, assessing and defining the best leadership for organisations, our teams bring their decades of expertise to help clients address their most complex leadership issues. We exist to improve the way the world is led.

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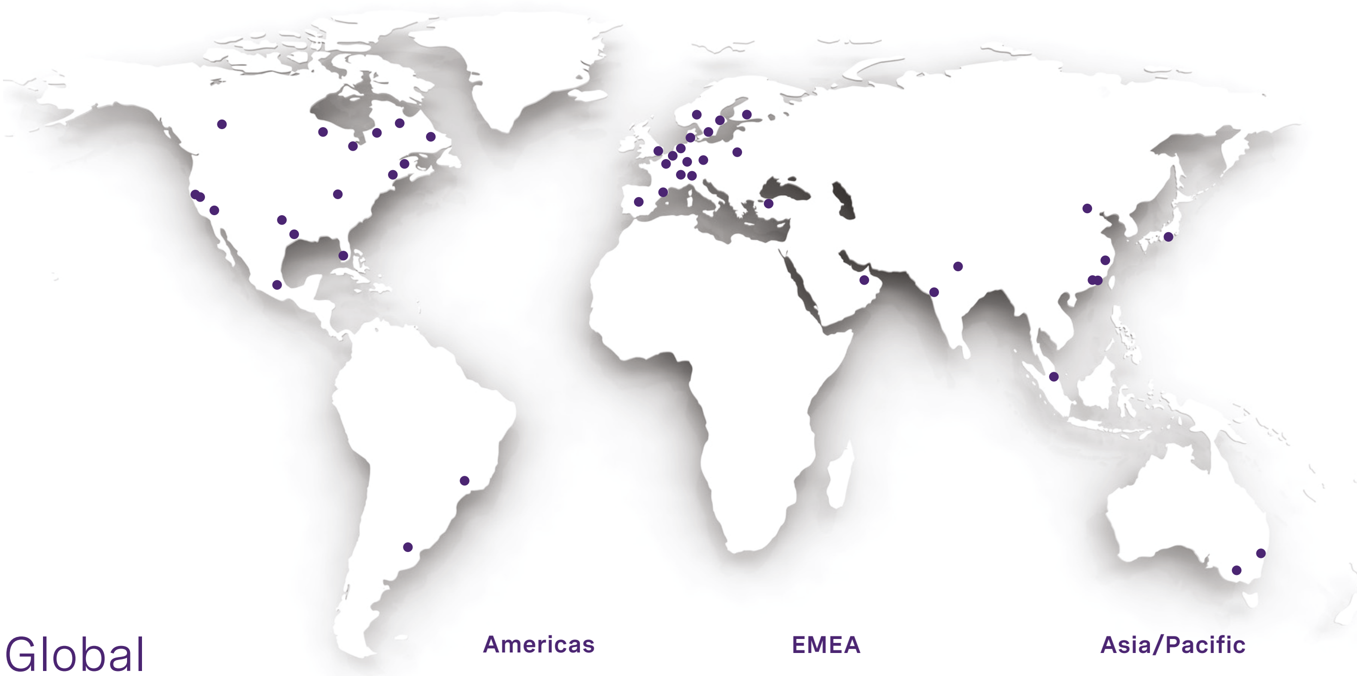

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