AN IPO IS STILL THE HOLY GRAIL

Is Your Team Prepared?

A successful initial public offering sets the stage for the company's first years as a public company, not only providing access to public capital markets, but also establishing the governance structure and finance processes that will support it over time.

Spencer Stuart has completed hundreds of CFO searches for pre-IPO companies, from fast-growing startups to major carve-outs, and provided advice to these organizations on building an IPO-ready finance team. Through our work, we have interviewed thousands of candidates, company executives and private equity leaders, gaining insight into the challenges of the pre-IPO period and the leadership needs of a company preparing to go public.

A question many organizations struggle with is whether or not the CFO needs to have previous IPO or public company experience, and what it means for the success of the IPO if he or she does not. Drawing on our own work with clients and conversations with board directors, executives and private equity partners who have been through the process, we offer the following five recommendations for preparing the finance team for an initial public offering:

- Start the process early
- Carefully define the CFO skill-set
- Think about IPO experience broadly across the team
- Place the right people in each role
- Plan for life as a public company (not just the IPO)

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Start early

An IPO is a massive and challenging undertaking, requiring a company to create new systems, identify and address talent gaps, manage the regulatory reviews and build credibility with analysts and investors, all while running the business at a high level. Given the demands on the finance team and the pace of the process, gaps in capabilities or systems will be exposed during the pre-IPO period, particularly if the company hasn't done financial disclosures in the past, and it can be difficult to get these capabilities in place quickly once the process has begun.

CFOs who have been through an IPO say it can take several years of preparation before a company has the systems, processes and team in place to go public. They recommend building out the team two years in advance and establishing systems and processes that provide transparency, enable accurate reporting and forecasting, and enable the evaluation of business performance on a quarterly basis.

"You can't decide to go public with a company that's ill-prepared today and expect to be able to go public in six months," argued Greg Ray, chief operating officer of Heritage-Crystal Clean. "It's going to take a few years of putting all the systems in place, establishing good controls and the audit trail to show that you've been checking those controls regularly, and having an outside audit firm validate that you're checking the controls regularly, so you don't have material weaknesses show up in an audit."

Define the CFO skill-set

Given the high stakes and risks inherent in an IPO process, it is little wonder that CEOs and private equity partners place a premium on having a CFO with previous IPO experience — even though outside advisers orchestrate much of the process in most cases. CFOs who already have led an IPO know how to communicate with external audiences and are likely to have existing relationships with key investors and analysts. They have a holistic view of the steps in the process and the schedule, and experience with forecasting and providing revenue guidance. Most important, they bring confidence to the process that translates into a willingness to ask the right questions, push back when necessary and protect the brand.

In reality, CFOs with prior experience taking a company public are in short supply, and most companies embarking on an IPO will do so with a CFO who is leading the process for the first time. We looked at the backgrounds of 255 CFOs of companies that closed an IPO in the past five years, and only 9 percent had prior IPO experience as a CFO. Just over one-third (36 percent) had previous public company CFO experience. In our work with private equity clients, 64 percent of our portfolio company CFO placements during the past three years had prior CFO experience, although not necessarily public company CFO experience.

While previous IPO experience is not a must-have qualification for the CFO of a company planning to go public, other skills are important. The CFO must have a thorough understanding of the drivers of the business and the company's financials, strong technical skills and a commercial sensibility enabling him or her to articulate sophisticated concepts clearly and crisply to investors who are unlikely to have patience for long-winded explanations.

Another important quality is confidence, particularly the confidence to push back on advisers advocating for a plan that is beyond what the company can deliver. "CFOs get pulled from many different directions, and you have to have a strong enough center that you and the CEO, as a team, understand what you're putting forward; it must be credible, consistent and correct. Companies and executives can be disporportionately punished for any mis-alignment between expectations and actual results," observed Jacqueline Reses, who led the U.S. media group at Apax Partners and is now executive vice president of people and development at Yahoo!.

Mike Nuzzo, CFO of General Nutrition Centers, agreed. "If you haven't had the experience, there's a tendency to let things happen — everything from the writing of the S-1 to the road show presentation and the format of investor meetings. The key thing to keep in mind if you're going through it for the first time is that nobody understands your business as well as you do. You have to make sure that you have direct input into the key areas that are meant to reflect what the business does and the attributes of the business."

During an IPO process, a CFO is viewed by investors and analysts as the primary point person on the company's finances, so he or she must be a credible spokesperson for these audiences. The finance team also plays a role in developing financial documents and investor materials, and must be confident that they tell an accurate story about the business. "CFOs need to have a sense of ownership of the financials. They need to be actively involved and deep into the details because there's going to be a point when they're in front of a crowd of people asking detailed questions, for example at an investment conference with analysts and investors. You need to understand the numbers inside and out so you don't embarrass yourself, your CEO or the company," said Michael F. Hines, who heads the audit committees for Dunkin' Brands Group and General Nutrition Centers.

Take a broad view of IPO experience

CFOs without IPO experience can shepherd a successful public offering if they surround themselves with the right team of internal and external expertise, including individuals who have public company and IPO experience. The broad team can include the CEO, senior finance leaders and outside advisers.

As they build out their teams in advance of an IPO, many companies prioritize IPO experience in new hires to complement an existing team without experience. For a company hiring a new CFO in advance of a public offering, experience with an IPO may be a "must have" if no one else on the team has that experience. At a company where the CEO and private equity sponsors have experience taking companies public, previous work with an IPO may be considered nice-to-have experience for candidates for the CFO role. Companies with no one on the team with previous IPO experience tend to rely heavily on outside advisers to guide them through the process and may also draw on the experience of board members who have served as directors or executives of public companies.

Build the right team

A public company has to close the books accurately and in a timely manner; convert accounting data into actionable information; and accurately forecast financials. It's not unusual for private companies to lack the depth and breadth of talent required to operate as a public company finance function. Many finance roles are likely to change and grow leading up to the IPO and once the company is public. "Companies tend to underestimate the amount of work that needs to go into this, from the internal controls, the Sarbanes-Oxley issues that need to be managed, but also what's needed on a go-forward basis, from a financial planning and analysis perspective," said Neil Shah of KKR Capital Markets.

Other factors to consider when building the finance team pre-IPO are the mix of public company and IPO experience that's required, the strength of the finance leadership team bench and the post-IPO plans of key finance executives. For example, some companies may bring on an IPO specialist who plans to leave shortly after the company goes public, so the company should focus on building a finance bench with succession in mind. In other cases, an experienced CFO who is planning to retire after the IPO may move into an advisory role, supporting a new CFO throughout the pre-IPO process and analyst road shows.

It also is important to carefully select the advisers who will be members of the company's extended IPO team, investing sufficient time in evaluating and selecting advisers. "CFOs do not tend to go through multiple IPOs of size, so it can be somewhat challenging for the CFO to really understand what they are going into. The degree of uncertainty is very significant, and one has to acknowledge that and seek out counsel and advice — and it has to be trusted counsel and advice," said Alan Campbell, CFO of Freescale Semiconductor who guided the company through its initial public offering and separation from Motorola in 2004.

External advisers should be very knowledgeable about the company and the industry, and there should be good chemistry between the management team and advisers. "We spent quite a lot of time early in the process interviewing multiple investment banks and multiple law firms and trying to find ones that we thought had the right experience and the right style to work well with us," Ray said.

Building the finance team

Executives who have been through an IPO point to several roles for which it is critical to have the right leaders.

Internal audit: A knowledgeable, experienced internal audit leader can orchestrate the process and build a strong team and processes for the long term. They go beyond compliance to find ways to run the business better.

Treasury: A knowledgeable and well-connected treasurer provides access to public debt and liquidity risk management.

Financial planning and analysis: Another key player is the head of corporate finance or financial planning and analysis, who can generate and interpret financial data and present it in a useful format, both for decision-making and reporting.

Investor relations: A strong IR professional has the experience and insight to help market the IPO, including an understanding of why investors will take a meeting and the ability to get feedback afterward.

Controller: An effective controller guides the development of appropriate internal controls, supports the CFO in creating the company's financial model and forecasts, and serves as a key contact with the independent auditors and regulators.

Think long term: Look beyond the IPO to life as a public company

"Everybody thinks about the IPO process as a point in time, when they really should be thinking about it as the start of being a public company," said Nuzzo. "The real work comes during the process, but the real pressure is that first quarter after you're public. As part of the pre-IPO process, you're preparing to make sure that the first quarter goes well as much as you're preparing to take the company public." Harmit Singh, who as CFO led Hyatt Hotels Corp. through its IPO process and is now CFO of Levi Strauss & Co., agreed: "Doing an IPO is not completing the process. It's phase I. Phase II is delivering."

In the pre-IPO period, analysts and investors are evaluating the strength and credibility of management based on their command of the business, the company's financials and the broader business context. In addition to setting up processes that are built for life as a public company, management teams will have many decisions to make about what financial and operational information the company is comfortable providing to analysts. Experienced CFOs recommend engaging the analyst community early in the IPO planning process to allow for more time to explain the complexities of the business and understand the kinds of questions that are likely to arise during the formal road show. Before the road show, preparation is key. Consider every possible question and have a plan for how the company will respond, including what information it will and won't provide. The quickest way to lose credibility with investors and analysts is to miss revenue or profit targets out of the gate as a public company, so don't overpromise.

"I've come to appreciate over the years that it's the uncertainty — rather than good news or bad news specifically — that public investors react to," observed a former CFO who led an IPO. "They don't expect that everything will always be rosy, but they do want to know that you have a handle on what's going to happen and understand how it's going to affect you and what you're going to do to respond."

Conclusion

Because of the challenges and risks involved in preparing for an initial public offering, CEOs and private equity sponsors frequently place a premium on having a CFO who has been through an IPO in the past. The market reality is that CFOs with successful IPO experience are in high demand and short supply. While these candidates may be the ideal choice, in many cases, the better fit may be a public company CFO or an experienced financial executive with deep and relevant industry experience. CFOs without IPO experience can lead a successful public offering if they begin the planning process early, build a strong team of internal finance leaders and external advisers, including individuals who have public company and IPO experience, and make decisions for the long-term health of the company.

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Cover photo: Section of a bronze door from Trinity Church in New York City.

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