IPO INSIGHTS

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Corporate Governance Practices for New Public Companies

Conducting an initial public offering is one of the transformative events in a company's lifecycle. Becoming a public company requires numerous significant changes that are necessary to handle compliance with SEC regulations, an accelerated financial reporting process, constant Wall Street scrutiny, and investor relations. Companies often hire a general counsel, a CFO and additional finance personnel in anticipation of an IPO. In addition, due to the corporate governance listing standards of the Nasdaq and NYSE, most companies are required to implement significant corporate governance changes at the time of an IPO. These changes include recruiting additional board members, creating independent board committees, and holding executive sessions with independent board members.

Public company boards are also subjected to more scrutiny from shareholders than prior to the IPO. The investment bankers taking a company public and the institutional investors that invest in an IPO will expect a company to comply with the corporate governance requirements of the national securities exchanges at the time of the IPO. The data presented in this publication indicates that newly public companies are not expected to implement "best practices" when it comes to anti-takeover protections. It appears that institutional investors are willing to accept these anti-takeover measures in newly public companies, whereas the same measures are subject to significant shareholder activism in larger, established public companies.

As the data in this report demonstrates, the vast majority of IPO companies implement a corporate governance structure that includes a relatively standard package of anti-takeover protections.

These protections consist of the following:

- blank check preferred stock;
- classified board of directors;
- advance notice provisions for shareholder proposals/nominations;
- no shareholder action by written consent;
- no cumulative voting;
- supermajority vote required to amend charter;
- limitation on removing directors without cause;
- board vacancies filled by board vote; and
- no special meetings called by shareholders.

It is interesting that each of these protective measures is in contravention of the guidelines of the major proxy advisory services (e.g., Institutional Shareholder Services or Glass Lewis), as well as the in-house governance advisors of major institutional investors.

Accordingly, what is not acceptable for a mature public company with a large market capitalization is perfectly acceptable for a newly public company that recently concluded an IPO. This poses two questions:

- First, why aren't proxy advisory firms and shareholder activists campaigning against these standard anti-takeover measures at the IPO stage?
- Second, why aren't companies adopting what the proxy advisory firms and shareholder activists are seeking at the outset?

With regard to the first question, most IPOs simply do not appear on the radar screens of governance advisors due to the relatively low market capitalization of these companies, as well as the small public float. Unless the company conducting an IPO has a market capitalization of at least $1 billion, or the company has a popular mass market consumer brand, an IPO company can can be reasonably confident that there will not be a significant amount of scrutiny applied to anti-takeover provisions. In addition, many proxy advisory firms provide a grace period to allow sufficient time for new public companies to develop better corporate governance practices.

With regard to the second question, newly public companies are implementing these standard anti-takeover measures in order to protect against the real threat of a hostile takeover shortly after the company goes public. Most technology companies are significantly smaller in size than, and are susceptible to a takeover by, the major players in the technology space that have vast amounts of cash on their balance sheets.

Very few companies desire to go through the trouble of executing an IPO and becoming a public company only to have their plans cut short by a hostile acquisition. The standard anti-takeover measures can stave off an unwanted advance, and enable a company to continue to execute the strategy it set forth in the IPO prospectus.

In conclusion, companies engaged in the IPO process should not be overly concerned that they are implementing anti-takeover provisions even though the provisions are contrary to the governance guidelines applied to larger and more established public companies. The ability to protect against a hostile takeover, and the market's wiliness to accept these anti-takeover measures in IPO companies, far outweighs the risk of shareholder activism after the company has been public for some time and grown to a level of interest for the corporate governance advisory community.

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