

European Growth Audit Network

December 2022

EGAN

SUMMARY OF THEMES

High-growth company boards confront volatile markets and consider IPO readiness

On 5 December 2022, the European Growth Audit Network (EGAN) met in London, with the following agenda:

- **Considerations for high growth companies and boards in volatile markets** with Alan Hudson from EY.
- **IPO readiness and transition to a post-IPO company** with experts from Nasdaq and law firm Cooley.
- **Challenges for directors of high growth companies** – a members-only dinner session

This document summarizes¹ the first two discussions.

Growth companies and their boards face volatile markets

Economic volatility, inflation, a recessionary climate, and operational challenges are creating an environment that many high-growth company management teams and boards may be facing for the first time. Alan Hudson, EY-Parthenon Turnaround and Restructuring Strategy Leader for the UK and Ireland, and members discussed how boards can provide guidance and oversight. Several key points emerged:

- **Financial and operational crises create an unprecedented environment.** Mr. Hudson said that the current situation is tougher than the financial crisis of 2008 or the COVID-19 pandemic. *“The support mechanisms are not the same. Government is not leaning in, and lenders and investors are more cautious.”* In addition to facing financial headwinds including inflation, rising interest rates, and the end of quantitative easing, companies are facing operational crises: low energy supply and high prices, fragile supply chains, soaring costs of labor, materials, transportation, and costs associated with sustainability.
- **Today’s issues are new for many management teams.** Mr. Hudson and members noted that most executives and some board members have thus far led through benign economic environments. *“The interconnectedness and complexity of current risks is*

something that boards need to be alive to and constructively challenge management on,” Mr. Hudson advised. A member concurred: *“Many people, me included, haven’t managed or led through an inflationary environment. A lot of companies are starting to come to grips with what that means and how to incorporate this into the planning process. For example, we’re doing scenario planning for different interest rate environments and working that into short and longer term planning.”*

- **Be alert to optimism bias.** Mr. Hudson said that, after many years of strong markets, readily available capital, low interest rates, and economic growth, management teams have become accustomed to sharing good news with boards, investors, and other stakeholders. And boards have been conditioned to receive good news or to believe that problems can be easily and quickly fixed. *“In many boardrooms, despite evidence to the contrary, there is a belief that companies will be able to navigate through without any hard interventions. There is an optimism bias, where management tends to focus on the positives, and there is an absence of debate or discussion around harsh realities,”* Mr. Hudson said. Good practices to combat optimism bias include:
 - **Actively challenge management.** Boards need to question management without coming across as overly critical. *“The challenge is to make sure management doesn’t stay overly optimistic, but also that they don’t fall into total nightmare pessimism,”* said a member. Another gave an example of pushing management to come up with a solution to a manufacturing problem, *“It’s really about calling on people to be creative on strategy, approach, and engagement.”*
 - **Reorient around what matters.** Even in a tough economic environment, most high growth companies can’t afford to stop investing in their businesses. Boards and management should agree on criteria for continued investment. Mr. Hudson highlighted the importance of continuing to look for opportunities and planning for when the market rebounds because *“historically, more businesses fail coming out of a recession than going into it. You need to judge where to cut and where to continue to invest so that you can bounce back and be prepared when the market recovers.”*
 - **Stay alert for fraud.** Downturns inevitably put pressure on management teams. *“Most frauds we see in this type of an environment aren’t people trying to enrich themselves,”* Mr. Hudson said, *“It’s manipulating numbers to try and buy time, hoping that things will right themselves when conditions improve.”* For instance, management may book revenue before it would be prudent to do so. A member added, *“It’s not so much willful neglect or fraud, but that’s why boards are there. Our job is to ask tough questions.”*
 - **Focus on liquidity.** In depressed markets, Mr. Hudson emphasized, *“cash is king”*. Accurate and current cash flow metrics can help a board decide when the company needs to cut spending—or signal that *“the CEO hasn’t got a grip on the business.”* He counseled boards to ask for monthly or even weekly cash flow projections.

- **Initial public offerings may be on pause, but preparation can continue.** Even where an immediate IPO is not on the cards, *“The prep work and practice of being a public company is good for a private company. Encourage the management team to use time as an opportunity to get ready and act like a public company,”* said a member. Mr. Hudson added, *“Think about the consequences of not being able to IPO. Is it IPO or nothing? What are alternative options to raise capital? What does it mean for the growth story? The story you create ahead of an IPO shows the strength of the team - how they evolved, prioritized, and then accelerated when the market returned.”*

IPO readiness and transition to a post-IPO company

The journey to a strong post-IPO company can be complex, lengthy, and challenging, even in the best of times. A global recession, high interest rates, and reduced access to capital have slowed the rate of public offerings. But IPOs require preparation. Claire Keast-Butler, Partner at Cooley, and Nasdaq’s James Beasley, Head of Board Advisory for EMEA, Adam Kostyál, SVP and Head of European Listings, and Isabella Schidrich, Senior Managing Director of EMEA Listings, discussed how companies and boards can prepare for IPOs, as well as good practices after an IPO.

Mr. Kostyál said, *“A lot of companies are getting ready to push the button when the time comes. Being ready isn’t something you do overnight.”* Ms. Keast-Butler offered questions directors can ask as their companies prepare for an IPO:

- **Is the executive team ready to lead a listed company?** Consider whether the top team has the necessary experience and expertise, including the ability to manage increased scrutiny and new stakeholders, such as public investors and analysts.
- **Is the board comfortable with the finance team’s ability to project and meet its numbers?** This is a significant IPO concern and boards should consider whether the company has the necessary personnel, systems, and organizations in advance of an IPO. Boards can review and stress test forecasts to check on finance capabilities.
- **What about support functions beyond finance?** Boards should consider the full range of capabilities—e.g., compliance, legal, human resources, investor relations, communications—necessary to operate as a public company. If there are gaps in resources or capabilities, the board should understand how management plans to close them.
- **How is the equity story being told—and is the board comfortable with it?** The board should help management describe the business model, competitive advantages, and growth plans. The board can help management stay true to the story and guard against the temptation to revise it based on short-term feedback.

- **What KPIs and non-financial measures will the business need to disclose?** Boards not only need insight into how metrics are determined and tracked, but they can help ensure appropriate metrics are disclosed and encourage benchmarking against peers.
- **What are the biggest risks to the company?** Boards should identify the most important five risks and, well ahead of an IPO, understand what is being done to manage them.
- **How will communications change?** High growth companies may prioritize transparency and openness, but public companies often need more tightly controlled information flows. Boards should ask management how communications will evolve leading up to and following the IPO.

The discussion surfaced three considerations for pre-IPO companies:

- **Start the dialogue with investors early,** Ms. Schidrich said, *“It’s really beneficial for investors to get to know not just the CEO but the CFO, IR, or a chief science officer at a healthcare company, so they have a good overview of where the company is and what milestones they are looking to deliver. If a company does that 12-24 months ahead of IPO, then they really build buy-in from investors.”* A member agreed, *“With the complexities unique to certain industries, you can’t assume investors get it, you have to really overeducate. And the board can really coach management on that, emphasize the value.”*
- **Understand emerging issues, especially ESG.** Mr. Kostyál noted an increase in ESG materiality assessments in pre-IPO companies. *“You will be drilled on that, so doing some sort of materiality assessment is a worthwhile exercise,”* he said. A member agreed, *“When I think about the role of the board and audit committee related to ESG, I see our most important job as pushing the company for proper materiality analysis before disclosing any information ... I’ve seen people who stop thinking after the E. But the S and G are important. So go through and think about the right focus. That’s where boards come into play.”*
- **Consider the board’s life cycle.** As a company progresses from private to public, boards should not only assess management’s fit, but also their own. *“As the company evolves, the board needs to evolve with it. Boards can frame their evolution through the lens of the director life cycle: defining and monitoring board composition; re-evaluating through board evaluations; appraisals of individual directors and developing training plans; planning for succession and delivering appointments; and onboarding for success,”* said Mr. Beasley.

Finally, members discussed key considerations for companies post-IPO:

- **You never get a second chance to make a first impression.** *“From our perspective, you’re never stronger than your first quarterly report. If you don’t deliver on that, it will be a very bumpy ride for the company and it can take a long time to get investor confidence back. So, executing on your first quarterly report is key,”* Mr. Kostyál advised.

- **Stay focused on compliance and procedures post-IPO.** Ms. Keast-Butler noted the emphasis, especially from legal teams, on policies and procedures leading up to an IPO. But, she said, that focus needs to continue after the offering. *“It’s really important that policies and procedures are complied with, so making sure there is proper training in the run up to an IPO and then on a continuous basis post-IPO will ensure they are permeated through the organization.”* A member concurred, *“The whole compliance area is much more visible in public companies, and even more focus is required in tough environments.”*
- **Don’t overlook tax.** EY participants stressed that tax, more than ever, is an important area of focus throughout the IPO journey. *“It is important to ensure potential tax exposures are managed in the run-up to an IPO to reduce the risk of value leakage,”* said Suwin Lee, EY Growth Markets Leader for EMEIA. However, she pointed out, that tax will continue to be an important consideration post-IPO noting, *“There is more scrutiny post-IPO, for example ensuring compliance in an increasingly complex tax environment with new taxes, like digital, carbon, and minimum tax.”* Lastly, she added, tax is now more strategic. *“Stakeholders want to see more detail on a business’ tax policy as compared to the past, where accounts often only included a brief comment.”*

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Appendix: Participants

The following EGAN members participated in all or part of the meeting:

- Nadja Borisova, BlaBlaCar and Pomegranate Investment AB
- Brenda Eprile, Atlantica Sustainable Infrastructure, Westport Fuel Systems
- Christoph Hütten, Brockhaus Technologies AG
- Sandip Kapadia, VectivBio Holding AG, Molecular Partners AG, and Passage Bio Inc.
- Linda McGoldrick, Compass Pathways, Alvotech, and Cranial Technologies
- Carolyn Schuetz, OakNorth Bank
- Sandra Stegmann, Bechtle AG

The following European Audit Committee Leadership Network (EACLN) members participated virtually in part of the meeting:

- David Meline, ABB

EY was represented in all or part of the meeting by the following:

- Ombretta Cabrio, EMEIA Assurance, EY
- Purvi Domadia, Partner, Market leader for FAAS/Capital Markets, EY
- Suwin Lee, EMEIA Growth Markets Leader, EY

Endnotes

¹ *Summary of Themes* reflects the network's use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments are not attributed to individuals or corporations. Quotations in italics are drawn directly from conversations with network members in connection with the meeting.