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HCM Viewpoint

Your governance and compensation are going public

Getting ready for your IPO

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Going public is a significant and critical step in a company's progression. Companies choosing to embark on this journey, often tend to see governance and compensation as an afterthought. However, as research confirms, good corporate governance and appropriate compensation constitute important cornerstones for providing investors with confidence in the company's sustaining success.

Going public means engaging with a wider stakeholder audience

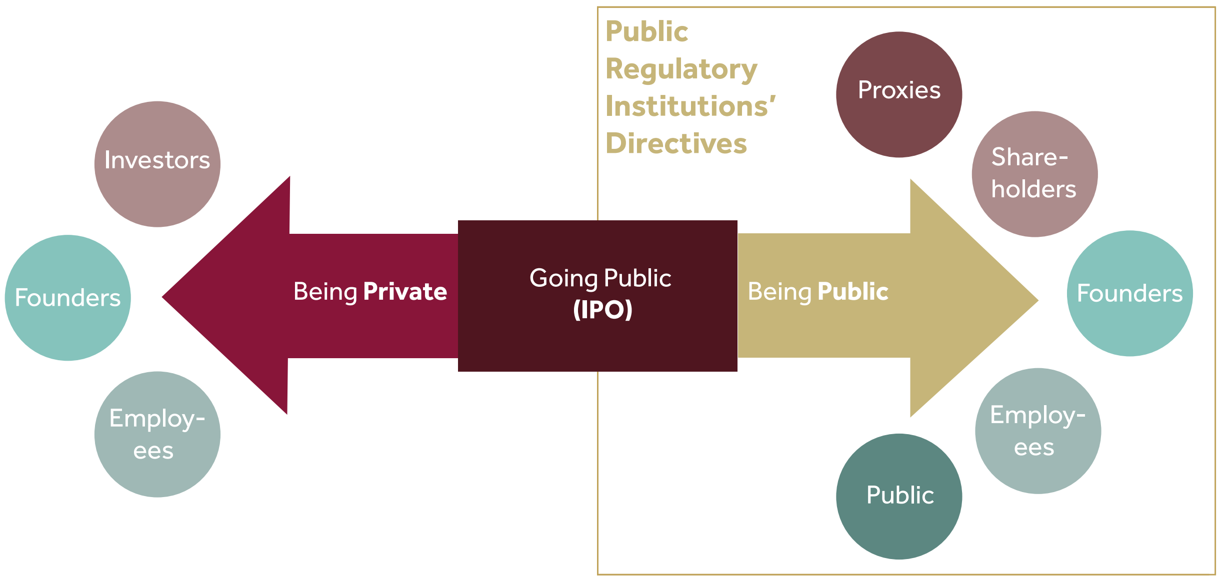
Going public means being accountable not only to increasing stakeholder demands but also to a broader spectrum of stakeholders. While most private companies are mainly accountable to their management, owners, and employees, public companies open themselves up to additional stakeholders. These are – among others – shareholders, the public, as well as proxy advisors.

Public companies are significantly more exposed to a wider set of opinions concerning their governance and compensation decisions. Changes are closely supervised, and if not accepted or comprehensible, could induce dissatisfaction and distrust among some of their stakeholders. If shareholders e.g. were to be dissatisfied with the structure and level of the company's compensation system, this could later lead to lower Say-on-Pay votes at Annual General Meetings (AGMs) or even to the sale of shares.

Shareholders and proxy advisors expect companies to disclose governance and compensation-related matters cohesively. This means that when e.g. Executive Committees' (ExCo) variable compensation is performance-tied, companies would be expected to communicate and disclose not only the performance criteria tied to this variable compensation, but also the degree to which performance targets may or may not have been met.

Not meeting stakeholder expectations could lead to reputational damage. Reputation is highly dependent on the wider public and media's opinion of the company's practices; also, with regards to publicly available data on governance and compensation. Though not directly linked to the immediate demands to be met, the public's opinion must also be managed, due to the implications it may bear on further business.

Once Swiss-based companies go public, the regulatory requirements and environment they are exposed to changes as well. Independent of their location of listing, the Swiss Ordinance against Excessive Compensation



Going public means facing a broader – more diverse – group of stakeholders and regulatory directives in Listed Stock Companies (VergüV) – aimed to increase shareholder voting rights – will become relevant to these companies upon listing. Rights invoked to shareholders under this ruling, include, but are not limited to an annual vote of Board of Directors (Board) and Compensation Committee composition. According to this legislation, shareholder approval is also required on maximum aggregate compensation amount for the Board as well as for ExCo. The compensation report is also expected to be voted on for approval.

Regulatory institutions as well as security and exchange commission (e.g. SIX, Swiss Code of Good Corporate Governance) demand a thorough adherence to their respective requirements (e.g. Directive on Corporate Governance) and generally heightened attention to risk-mitigating efforts.

In sum, a proper understanding of requirements needed to be met and proactive stakeholder engagement management are key to coping with the increasing number of requirements a company faces once becoming public.

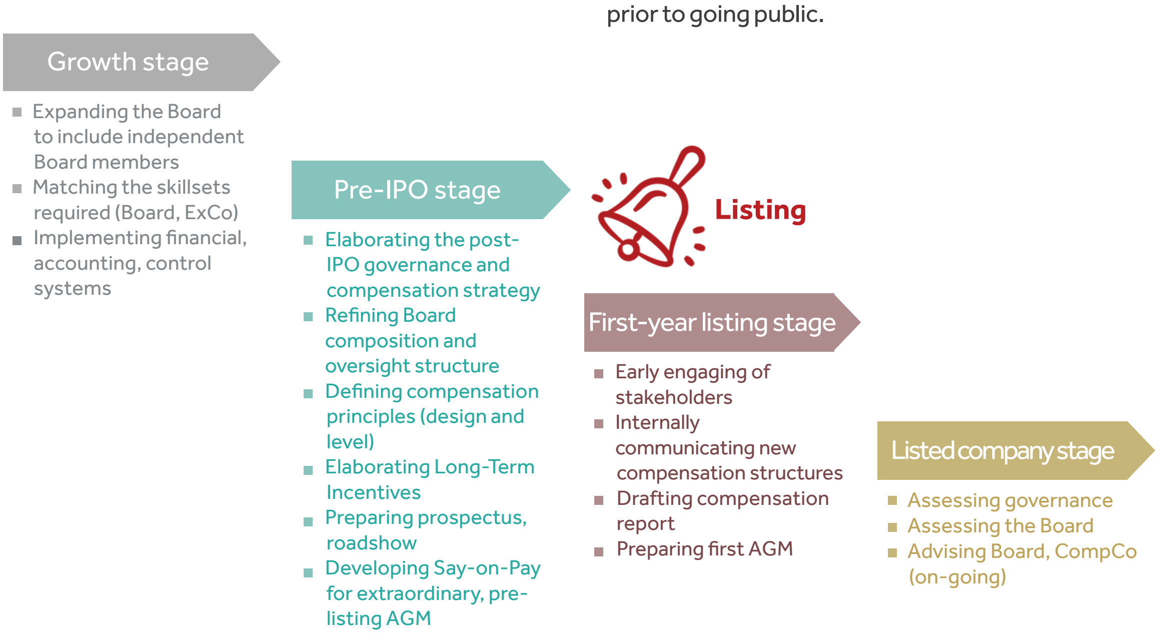
Preparing for life as a publicly listed company

One must note that what may work for privately owned firms may not necessarily work for publicly listed companies. Each stage in the listing process and beyond requires careful planning and attention; setting the right focus on governance and compensation-related topics.

Growth stage – Laying a solid foundation

Thinking ahead in terms of governance and compensation-related topics – during the growth stage – lays the basis for a smoother transition into public life. Moreover, research shows that shareholder-oriented, transparent governance structures at the time of an Initial Public Offering (IPO) are associated with both a higher initial company valuation and better long-term performance[1].

As companies strive to further grow and eventually go public, they ought to introduce more structured and formal decision-making and oversight processes, helping them better mitigate inappropriate risk-taking and set up compliance management processes. An effectively developed corporate governance structure requires time and attention and is often implemented two to three years prior to going public.



Relevant governance and compensation topics along the going public process

1 *The Implementation of Corporate Governance in Pre-IPO Conpanies*, Harvard Law School Forum on Corporate Governance and Financial Regulation, 2018

As private companies' Boards are commonly composed of mainly non-independent founders, investors and management, scaling up the Board with independent members often constitutes one of the first steps to strengthen their governance. It also closes the gap towards the expectation of having a majority of independent members in the Board, as described in the Swiss Code of Good Corporate Governance (article 12, 14) once public.

Other gaps that companies may be able to bridge, include diversity, internationality, professional experience, expertise and the size of the Board. Furthermore, depending on the company's specific situation, it may not only need to amend the Board's composition, but also that of other key functions in the organization to affront the requirements ahead as a publicly listed company. Companies further advanced in the growth stage may even consider onboarding a Group Counselor or introducing an Internal Audit function.

Additionally, the implementation of internal control systems (ICS) and the shift toward internationally accepted accounting principles e.g. IFRS, typically also takes place during this stage.

Pre-IPO stage – Targeted preparation

Although companies entering the pre-IPO stage will have already updated and further developed corporate governance structures. These, as well as current compensation systems, should nonetheless be more concisely reviewed in light of the upcoming IPO.

One way to effectively pursue the necessary review is by executing a readiness check for governance and compensation topics. This constitutes an opportunity to assess the company's hereto related practices' alignment with regulatory requirements, market best practices and potential investor expectations, prior to the required consequential disclosure as companies become publicly listed.

Corporate Governance	
▪ Ensure that the governance and oversight structure of the Board is in line with regulatory requirements and guidelines[2]	✓
▪ Review and amend Corporate Documentation (e.g. Articles of Association, Organizational & Committee Charters)	✓
▪ Review ownership structure and treatment of outstanding awards (e.g. Phantom Shares)	✓
Compensation Framework	
▪ Review/develop compensation strategy & objectives for the Board and ExCo	✓
▪ Evaluate/benchmark appropriate compensation for the Board and ExCo ○ Design: compensation instruments and structure ○ Levels: market positioning ○ Instruments: types of fees for Boards and compensation elements for ExCo	✓
▪ Examine establishment of an IPO-related incentive	✓
▪ Check compliance of ExCo employment contracts, in terms of e.g. no severance pay, and length of notice periods	✓

Readiness checklist[3] for governance and compensation topic

In a first step, governance structures need to be assessed in context of their accordance with the post-IPO strategy, as well as the fulfillment of specific regulatory requirements relevant to public companies. This consists of the Board's composition (e.g. target size, board independence prior to listing, nominating a chairperson), as well as its respective roles and responsibilities.

Secondly, the review of corporate documentations incorporates – among others – the amendment of the Articles of Association (e.g. organization of the company, and if applicable, foreseen conditional capital as reserve for future equity plans, reserve amounts for new hires, and specification on voting regimes, etc.), and the formalization of the Organizational Charter as well as the respective Committee Charters (e.g. Audit, Compensation, Nomination and Governance Committee).

2 Ordinance against Excessive Compensation in Listed Companies (VegüV), Swiss Code of Best Practice for Corporate Governance

3 The IPO readiness checklist should be put in each company's context and can be extended on a case-by-case basis if required

In a third step, the company should also review their current employee ownership structures. Going public bears the advantage, that the spectrum of available compensation instruments widens. Pre-IPO, private-company compensation schemes are normally characterized by heavily equity-award driven compensation, including the use of e.g. phantom shares and options. These are generally distributed among a narrowly eligible group of people – usually founders and top management. With the introduction of the company onto the stock market, companies can now make use of e.g. effective performance-based equity participation plans. In so doing then, companies will consequentially necessitate amending existing variable pay plan regulations, as well as adjusting former shareholder agreements.

In terms of compensation, it is important that companies align their compensation framework and strategy with their intended overarching post-IPO strategy. In defining the compensation framework, companies must also determine pay levels, the type of fees in the case of the Board and the pay mix of cash and equity compensation. In the case of ExCo, aligning their own and shareholders' interests is a crucial subject, typically covered by the implementation of long-term incentive plans, as these incorporate pay for performance elements.

A key determinant in the development of compensation structures will be benchmarking the nature and composition of compensation elements, as well as pay levels against a pre-defined peer group to determine the company's market positioning. The careful selection of the peer group – customarily done separately for Board and ExCo – needs to be based on an objective approach. In so doing, the company can attain a high level of framework acceptance among all involved internal and future external (e.g. proxies) parties.

The pre-emptive establishment of a sound compensation framework gives companies the possibility to more rapidly adapt to public listed life, and further on, to evolving market practices. Additionally, the implementation of a new plan is ordinarily easier as a private company. The room for potential change is bigger and the chain of approval significantly shorter. This allows for more agile responses to address adjustments. One element necessitating careful consideration, is the possibility of establishing an IPO-related incentive. This would serve the purpose of retaining talent and motivating employees for the jointly achieved success.

Lastly, in light of the upcoming listing, companies require all governance and compensation related matters to be compliant in terms of e.g. respecting a maximum length of notice periods and ExCo employment contracts with regards to excluding severance pay. These must also be compliant with e.g. IFRS and local tax authority-imposed requirements. Depending on the design of compensation schemes, moreover, these considerations may even affect the resulting pay-out for participants and cost of compensation for the company, not only in Switzerland, but globally.

In conclusion, robust governance and compensation structures – which must be described in the prospectus and explained during the roadshow– are necessary to instill trust and confidence in potential investors.

First-year listing stage – Properly communicating

Communication gradually gains in importance, starting as early as the roadshow during the pre-IPO stage, usually reaching its peak during the first year after listing. The extent to which companies communicate both, with their internal and external stakeholders increases as they become accountable to a larger audience.

Internally, this means that the Board and ExCo should take the opportunity to communicate and explain the company's strategic objectives; reflected in the variable compensation. By using appropriate performance measures in short and long-term plans, companies can further effectively align the interests of key individuals in order to achieve the company's long-term objectives.

Externally, the increased number of stakeholders to whom the company becomes accountable, demand tailored information on a diverse set of subjects. The governance and compensation reports are two main instruments for communicating information on said subjects to the shareholders, whereas Say-on-Pay shareholder rights – exercised during AGMs – represent the shareholders' direct communication with the company. Companies concluding their listing must pay careful attention when preparing their first AGMs. This requires special attention, as items such as the maximum aggregate compensation amounts for the Board and ExCo are bindingly voted on.

Conclusively, it is recommended that companies not only engage with key stakeholders (e.g. major shareholders or proxy advisors) at an early stage, but also maintain an open dialogue with opinion leaders, to warrant a higher satisfaction rate among them.

Listed company stage – Warranting consistency and staying up-to-date

After surpassing the first year of listing, companies ideally reach the paramount stage in dealing sustainably with governance and compensation-related topics. However, in order to maintain sustainability in these two practices, the members of the Board, have the duty to oversee all matters related to governance and compensation continuously.

The Board should itself regularly conduct Board assessments, in terms of its own composition with regard to structure, tenure, and capacities, as well as its effectiveness in pursuing their tasks and responsibilities. In its entirety, the Board is responsible for the overall oversight of itself and the company's governance.

The Compensation Committee (CompCo), assists the Board in determining and reviewing the compensation framework and guidelines, when necessary. It does so, to ensure the long-term orientation of compensation practices and proper pay for performance pursuit. The CompCo is further entrusted with the maintenance of oversight over the effectiveness of ExCo compensation, elaborating appropriate targets and overseeing the CEO's compensation package.

Ideally – when both the Board and the CompCo are diligently pursuing their duties – the need for change will hence arise only within reasonable scope and timeframes.

The Board requiring to pursue recent market developments concerning the compensation, regulatory and governance landscape, will oftentimes bring on an independent, external advisor to facilitate keeping up-to-date and offering additional, less obvious market insights for the Board and its committees. This allows the Board in its totality to diligently and completely pursue all its duties and responsibilities.

Governance and compensation remain relevant considerations beyond the listing process

The IPO listing process does not follow a "one-size-fits-all" approach. Some companies may have further developed governance and compensation systems than others, consequentially requiring fewer individual amendments. Each of the four stages that a company pursuing listing typically passes – growth, pre-IPO, first year listing, listed company – requires a tailored focus and carefully-planned steps.

Often established in the growth stage, robust governance structures lay the foundation for companies' IPO pursuits. Hereby, the focus clearly lies on demarcating governance structures with the appropriate Board compositions, inclusive of the necessary skillsets and independency-criteria.

The pre-IPO stage is critical to a successful, almost impending listing. Here, companies are required to review their governance and compensation systems in a detailed manner. The readiness check is an effective instrument to assess potential gaps. As a result, it constitutes an opportunity to amend the company's corporate governance and compensation practices' alignment with best market practices and regulatory requirements prior to the required disclosure, once public. Moreover, it can aid or even accelerate the effective pursuit of going public.

In line with this assessment then, the company will need to visualize and elaborate its governance and compensation systems implemented in the prospectus ahead of the roadshow. This step will aid companies instill confidence in their potential shareholders, on the company's sustaining success.

Once the company has gone public, communication becomes an ever-growing important cornerstone. Going public means being accountable to a larger stakeholder audience, which at the same time will expect more thorough knowledge on the happenings of the company. Likewise, shareholders of publicly listed companies are generally more reluctant to sudden, unforeseeable changes or adjustments in governance and compensation systems, than private investors. For this reason, once public, governance and compensation should remain sustainable and long-term oriented. It is recognized as best practice for compensation plans to first live through a cycle, prior to making changes. That is to say, that while minor changes should be made to maintain an effective governance and compensation, larger alterations should be refrained and be addressed on a continuous basis, so as to instill confidence in the company's long-term orientation and success.

About the Authors

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Nadine Balmer has over 15 years of international management consultancy experience leading projects in the field of executive compensation, financial management and corporate governance. She has advised companies in numerous industries such as financial services, energy, construction, logistics, including companies going through various phases of transition, such as those involved in going public or preparing for succession.

Ms. Balmer earlier worked for several international companies in the field of organizational development, executive compensation and process optimization. She holds a Master in Accounting & Finance of University of St. Gallen and a Master of Science of Ecole Polytechnique Fédérale de Lausanne (EPFL).

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Donata Bauer graduated from the University of St. Gallen (HSG) with a bachelor's degree in Business Administration. She wrote her bachelor's thesis on the quantification of project success along the criteria of the Iron Triangle of project management: time, budget, and scope. She further gained international exposure during her studies during a semester abroad at the Singapore Management University.

Prior to joining HCM in 2018, she gained practical experience in various fields, including in strategy consulting, controlling and tax.

About HCM International

Every company is different. A uniform recipe to guarantee the successful outcome of Initial Public Offerings (IPOs) does not exist, what is clear, is that each company contemplating the thought of an IPO should understand the process related to governance and compensation topics thoroughly.

A successful IPO launch comprises re-evaluating governance and compensation topics such as design and appropriate levels, as well as the improvement of communication quality with shareholders and stakeholders from the get-go.

This constituted list of non-exhaustive considerations, such as underlying reputational risk factors, such as proxy vote recommendations may also play a vital role in the long-term sustainability of being a successful listed company.

Particularly with regards to IPO-related compensation and governance changes, our most recent clients include amongst others: Swiss-based pharmaceutical and biotech companies, leading wholesale suppliers, leading industrial firms, and logistics companies.

After assisting numerous IPOs in the past ten years, HCM has proven its expertise and capabilities in these fields for helping clients not only successfully establish corporate governance and compensation structures fit for compliance and public scrutiny, but also proactively prepare for a successful future life as a public company in terms of proxy advisor discussions, AGM invitation, Say-on-Pay, etc. HCM is also assisting compensation committees with agenda-setting, target setting for variable pay plans, and company-specific requirements, once the company has been listed.

HCM has extensive experience working with companies around the world. In each case, we factor in a company's individual situation and complexity. As governance and compensation experts, HCM also supports companies in ensuring that governance systems and managerial incentives are properly calibrated to promote sustainable financial and long-term corporate success.

Should these topics interest you or be of current concern to your company, please do not hesitate in contacting us for a non-binding discussion anytime.

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