BoardMatters Forum

November 2022

Building a better working world

Key considerations and challenges faced by boards of emerging companies, pre and post their IPO listing

In 2022, many emerging companies that had made headlines with highly successful IPOs, faced regulatory hurdles and investor sell-off pressures. This put governance of emerging companies under the spotlight, posing a challenge for their boards.

EY hosted the BoardMatters Forum (BMF) meeting on 15 November 2022, which included a panel discussion on 'Key considerations and challenges faced by boards of emerging companies, pre and post their IPO listing'.

The panel was moderated by Prashant Singhal, Partner and EY Global Emerging Markets Leader for Technology, Media & Entertainment and Telecommunications (TMT), and comprised the following:

- Anand Deshpande, Founder, Chairman and Managing Director, Persistent Systems
- Kaushik Dutta, Chairman, Zomato and Independent Director, HCL Services, Policy Bazaar, Snap Deal, and NDTV
- Sandeep Kher, Director, Sequoia Capital India
- Milind Sarwate, Founder & CEO, Increate, and Independent Director, FSN E-Commerce (Nykaa), Asian Paints, Mahindra & Mahindra Financial Services, Metropolis Healthcare and Hexaware

Panel discussion

What does being an independent director (ID) on the board of a high-growth new-age company entail?

A mature company has stabilized processes and systems, so independent directors (IDs) may have to spend less time on these aspects. However, emerging companies require a larger share of an ID's energy and time. The IDs will guide the team, assist with or lead in setting the processes, and, overall, bring maturity to the system. This could be before or after the IPO and requires more participation as compared to a mature company. The fundamental difference lies in the processes and regulatory requirements.

An ID's role in an emerging company differs from that in a well-established company. Responsibilities largely depends on what the promoter, chairperson or board expect from an ID. It could be of an expert or a general adviser. The role's ambit will also determine the committees that the ID is a part of, in addition to the key fiduciary duty on the board.

While IDs may have various responsibilities, ideally, non-executive or independent directors cannot handle commercial activities. Hence, defining the role is important: does the company need an adviser, a consultant, or an ID? Doubling up of IDs with consultants and advisors can clearly be a potential conflict of interest.

It is essential to understand the different expectations, especially from the founder(s) and the investors. It is important that they are aligned to their purpose. Founders often want a board that is stable and participates in decision-making, as their entrepreneurial journey would have been full of trials and decision making. Therefore, the IDs must have open communication with all involved to build relationships and avoid being in conflicting situations.

Understanding the founders

Founders of most emerging companies have been self-reliant for most of their entrepreneurial journey. Therefore, when the company reaches a stage of preparing for an IPO, founders are looking for support and guidance as they chart the company's future course. If founders have a good understanding in certain areas, they may want IDs' viewpoint to complement theirs.

An ID's responsibility to a founder also includes 'saving you from yourself'. Many founders find it difficult to relinquish some of the responsibilities. Therefore, it is important to handhold them and explain that external expertise will ultimately benefit the organization's growth.

Besides clarity on expectations, there has to be mutual trust so that founders can focus on growth and strategy. However, building trust can take time, even a few years. Founders normally would see IDs as a sounding board in the entire IPO process, from a regulatory and experience standpoint.

What PEs want from IDs

Growth is fundamental to an emerging company, and the approach should be calibrated accordingly. It is important to understand the company's ecosystem as many of the founders are young and may not be aware of or oriented towards organization, processes and governance. This necessitates grasping the company's nuances outside of the board, which can be done by meeting the CFO and other business heads.

Emerging companies need growth plus governance and agility plus stability. Good governance would be of little value if the business is stagnant or weak. Many of the companies would have seen rapid growth and therefore, an ID's initial focus should be on building processes by relying on data instead of individuals, though the temptation may be to focus on outcomes or results. In the role of advisers and decision-makers, one must exercise sufficient professional skepticism and not hesitate to put forth critical views and evaluations.

IDs as board members have one main responsibility and that is duty of care – diligently following processes before arriving at a conclusion. The question is duty to whom – promoters/founders/investors etc. and the discussion led to the conclusion that what is right for the company is right for all stakeholders. Transparency must be a dominant factor as one has promised to take on the duty by signing the business responsibility statement.

Is there a right time for on-boarding IDs?

Founders can gain a lot by having at least one or two IDs even before the VC funding stage. The expertise, guidance, and support will strengthen the company's position in getting VC funding.

Having an ID's counsel during the early stages can be beneficial in two other ways: 1) Bolstering the position of founders if there is concern about a VC takeover. 2) Providing crucial expertise to founding teams that do not have the training or skill sets to run large companies or manage exponential growth.

During the IPO process too, IDs can provide direction. Investment bankers, for instance, come with different perspectives. In such a scenario, IDs' advice and experience can help founders make the right, independent decisions.

While there is no rule as to when a startup or emerging company should bring in IDs, but the general trend is a year before the IPO. Most companies, however, start building processes much before the IPO and therefore on-board IDs early on to gain from their expertise in governance and other fields would be beneficial. Ideally, onboarding of IDs should happen two to three years before a potential capital market transaction to make it beneficial for a company.

The stage at which IDs enter is important. The role differs if they enter during the growth stage compared to early stages. Having semi-executive responsibilities can make it difficult to be independent. For instance, an IPO intensely pressures the company's processes. Therefore, it is important for the board to set ground rules on the scope of duties for the IPO, i.e., what they will or won't do.

The IPO process involves multiple stakeholders: promoters, founders, investors, bankers, lawyers with the regulator always present as an invisible stakeholder. The entire process is driven by the company's management, but most of them may not be part of the board. Therefore, an ID has to perform the balancing act among all stakeholders. To fulfill this function, an ID should ideally join at least 18 to24 months before the IPO process begins. Otherwise, there will be very little time to understand the company, its governance and be able to take responsibility on the IPO.

Companies and founders must realize that during the initial phases, it is important to get people who understand business and as one nears the IPO stage, domain expertise is required.

On new SEBI rules on committee of independent directors recommending IPO pricing

SEBI rule: According to the new rule, the regulator has mandated that the issuer's committee of independent directors also has to make recommendations on the IPO price band based on certain KPIs and specified historic share price data. This can be price per share in primary and secondary transactions during the 18 months prior to the IPO, and other share acquisition price-based data.

Panel's view:

IPO pricing is ultimately a market-based phenomenon, though multiple stakeholders are involved in arriving at a price band. A recommendation by a committee of IDs is an added step to the procedure. Usually, an investment banker recommends a price band. The issuer considers two more valuations and opts for the most conservative option. However, the price is determined by the market and the prevailing environment finally.

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