
THE CEO'S OVERVIEW

People tend to think of going public as a goal in and of itself—as the end of the process. It isn't. It's the beginning of a long-term relationship with the public and institutional investors.

Sunhil Wadhvani, CEO, Mastech Corporation

An IPO (initial public offering) can mark a turning point in the life of a company. With this one event, the company can accelerate its growth, launch new products, enter new markets, and attract valuable employees.

Those who consider the IPO as just a short-term financial transaction underestimate its far-reaching impact. Ernst & Young views the IPO as part of the Value Journey, a journey of transformation from a successful private company to a successful public company that continually delivers value to its stakeholders (shareholders, employees, customers, vendors, etc.). The IPO event itself is only one component of this journey. The IPO event generally lasts 90 to 120 days, whereas the Value Journey begins at least a year or two before the IPO and continues well beyond it.

It is up to the CEO (chief executive officer) to anticipate the leadership challenges along the Value Journey and to lead the management team through the major operational, transactional, and people milestones. An IPO places CEOs in an odd position: they are being called on to be the quarterback in a game they may never have played, which means they will need all the leadership qualities they can muster. They will have to be visionary and architect, quarterback and cheerleader, spokesperson and manager.

Above all, they will have to become an evangelist whose fervent vision can motivate a variety of stakeholders and can steer the company toward competitive advantage. Much of the success of an IPO depends on the credibility and trust that the CEO can build—the employees' trust that

the CEO will lead them in a beneficial direction and the market's trust that the CEO will deliver on his or her strategic plan.

The Value Journey is littered with land mines. Why do some companies succeed dramatically while others fail? What critical success factors set the CEOs of highly successful companies apart from their peers?

ANATOMY OF A WINNER: THE RESULTS OF THE ERNST & YOUNG STUDY

To identify the keys to a successful IPO, Ernst & Young and researchers at the Harvard University Graduate School of Business launched "Managing the Success of the IPO Transformation Process," the second in a series of *Measures That Matter* research projects. The survey population included senior executives of some 2,500 companies that launched IPOs between January 1, 1986 and August 31, 1996.¹ The response rate exceeded 20 percent (517 responses). Participants were asked to rate the long-term results of their IPO as highly successful, successful, or unsuccessful. These and other survey responses were matched to objective data describing each company's market performance (sales, net earnings, and market capitalization) for three years after the IPO.

The study yielded some strong indicators of the characteristics and practices that are associated with a successful public company. The following description of the survey results is meant to serve as a benchmark for CEOs who are considering a public offering. How does your company measure up?

- ***Highly successful companies outperformed the competition before, during, and after the IPO.*** Competitive position at the time of the offering was particularly critical. The stronger the firm was before the IPO, the more successful it tended to be after the IPO. Conversely, the risks of going public were higher for those that were less competitive at the start.

The highly successful companies were significantly stronger than their public competitors according to all financial and nonfinancial criteria. As a result, highly successful companies went public with share prices that averaged 20 percent higher than those of unsuccessful companies. In their

¹Failed and untraceable companies were weeded out. Real estate investment trusts, warrant and unit offerings, non-U.S.-based companies, and penny stocks were not included.

IPOs, highly successful companies had an average market value that was \$59 million greater than the market value of unsuccessful companies; three years later, the gap widened to more than \$205 million (see Exhibit 1.1).

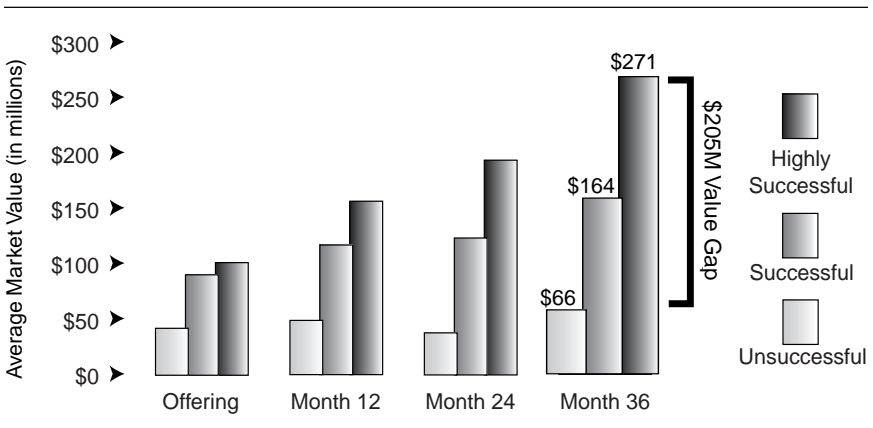
The average value of highly successful companies doubled during the first three years after the IPO; unsuccessful companies lost an average of 10 percent of their value during the same period.

• **Highly successful companies began to transform themselves into public companies months or years in advance of the IPO.** These companies viewed the IPO as a process rather than as an event. As part of the process, they introduced new approaches and/or system enhancements, executed strategic transactions, and implemented strong communication programs. Fifty-seven percent of the respondents made improvements in their employee incentive programs; these changes were believed to have had a greater impact on the company's subsequent performance than any of the other 17 policies and practices that were cited. Highly successful respondents also tended to be distinguished by improvements in strategic planning, internal controls, financial accounting and reporting, executive compensation, and investor relations policies.

Of the executives who reported successful offerings, 66 percent also revamped their plans for such transactions as acquisitions, recapitalizations, and other financings immediately before or after the IPO.

It is especially important to note that the earlier the change initiatives were put in place, the more likely was the success of the IPO. Those who

EXHIBIT 1.1. The value of success—difference in market value between unsuccessful, successful, and highly successful companies.



launched such programs a year or more before the offering were much more likely to achieve success.

- **Nonfinancial success factors are critical.** The most successful companies ranked high on such nonfinancial measures as the credibility and the quality of management, retention of employees, customer service, and the strength of their corporate culture. They tended to be ahead of competitors in building a winning team, developing an information-based infrastructure, and drawing on the advice of experienced and objective business advisors. These efforts won them the attention of the most successful venture capitalists and underwriters, which further supported their higher offering prices and a stronger reception from investors (see Exhibit 1.2).

AN EXECUTIVE SUMMARY OF THE IPO VALUE JOURNEY

Our study, *Managing the Success of the IPO Transformation Process*, strongly corroborates our experience as business advisors: For successful

EXHIBIT 1.2. Success factors.

Financial Performance	Nonfinancial Performance
Sales	Quality of Management
Profitability	Quality of Products and Services
Return on Assets	Level of Customer Satisfaction
Cash Flow	Strength of Corporate Culture
Sales Growth	Quality of Investor Communication
Income Growth	Effectiveness of Executive Compensation
Market Share	New Product Development Capability
Cost Control	Innovativeness/Research Capability
	Research Productivity
	Strategic Planning
	Strategy Execution
	Management Credibility
	Ability to Attract and Retain Employees
	Quality of Major Processes
	Market Position/Leadership

Superior performance along every one of the eight financial and fifteen nonfinancial criteria is strongly associated with long-term financial and nonfinancial success.

companies, the IPO was merely a highlight in a value-creating journey that spanned at least three or four years and presented a series of leadership challenges to the CEO.

The following is a brief account of the Value Journey and the leadership challenges that arise at each stage of that journey. Although many of the challenges may not present themselves in any particular order, they should be approached systematically. The challenge “Define Success” is logically first because it becomes the framework for every challenge that follows. The first five leadership challenges typically occur in the planning phase of the Value Journey; the next four occur in the execution phase; and the last two occur in the realization phase that follows the IPO event.

The Value Journey is meant to be used as a scorecard. On some items, you will score high and will not need to implement any changes; other items may indicate gaps you need to fill. It is up to the CEO to meet each leadership challenge with action steps that move the company toward the goal of becoming a successful public company.

Define Success

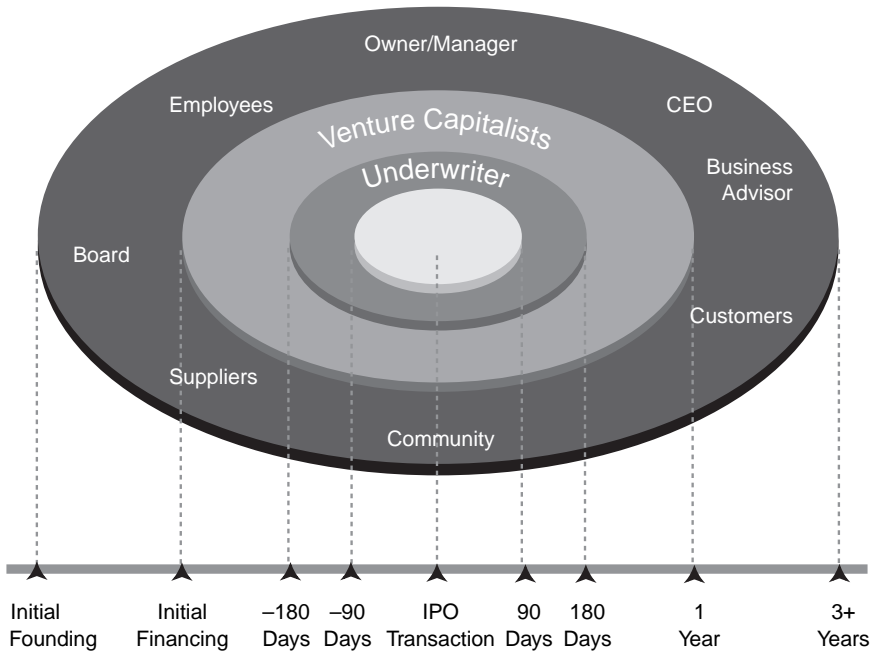
Your definition of *success* is like a compass that can guide you. Your path will be much clearer because you can align it with what is truly important to you personally and to your company.

Your definition of success should include personal as well as corporate goals, nonfinancial along with financial goals. It is particularly important to define what is important to you as well as what is important to your other important stakeholders. The time frames of various stakeholders will be different (see Exhibit 1.3); for instance, the investment community will define success primarily as short-term returns, whereas employees and customers will be concerned with long-term performance. Such differences may point to decisions that you need to make.

Chart Your Business Strategy

Designing and executing a compelling business strategy are probably the key responsibilities of the CEO. Two parts of this exercise are important: a clear snapshot of your company as it is today and a moving picture of where your company is heading.

EXHIBIT 1.3. Different views of success.



This is the time to prepare a thorough business plan that can serve as your own road map and that can communicate your vision to potential investors and other stakeholders. It is also the time to set priorities and, perhaps, to consider alternatives to a public offering. A natural law of value creation is that all companies are in the process of either growing or dying. Which parts of your company are creating value? Which parts are destroying value? How much time do you have?

It is helpful to think about priorities in terms of (1) the value they create and (2) the ease with which they are implemented. For initiatives that are difficult but create the highest value, you need to have the right resources. At the same time, it makes good sense to pick the low-hanging fruit. A compensation plan is an example of a relatively simple initiative that creates considerable long-term value. The point is to achieve a balance and to stay aligned with the goals you have defined for yourself and your company.

Be An Accelerator

In today's marketplace, speed is a critical differentiator of successful companies. The new economy says that value is driven by being first to market. It's no longer just "big companies beat small ones"; it's also—and more important—fast companies beat slow ones.

Consequently, a CEO needs to find ways to take the business as it is today and accelerate it to a different level. Looking back at your definition of success, which of your goals can you accelerate in the next 12 months? You may want to move faster in developing a new product, penetrating a new market, completing an acquisition, or preparing a compensation plan. What are the factors that enable or that inhibit your acceleration plan? What resources are needed?

Chart Your Transaction Strategy

Internal growth takes a company to a certain level; a transaction can take you to another level. You may want to implement one or more of a number of strategic transactions: acquisition, alliance, divestiture, recapitalization, private financing, and so forth.

Your challenge is to design transaction strategies that will accelerate your goals. Transactions are fraught with risk. We define the *successful transaction* as the right transaction undertaken at the right time in the right way. Many companies initiate an acquisition or an alliance to build critical mass, or they initiate a recapitalization to obtain liquidity. Yet many deals fail because management was not able to realize the value after the deal. For example, although the market generally rewards acquisitions, a full 77 percent of all acquisitions fail to equal or exceed the cost of capital (see Exhibit 1.4).

Chart Your Own Personal Strategy

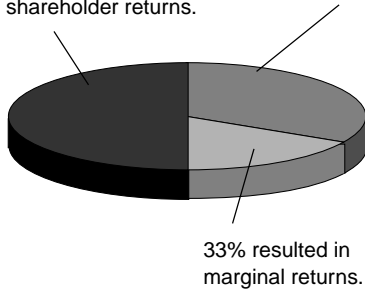
Oddly enough, many business owners and CEOs are so busy focusing on creating wealth for the company that they neglect their own personal wealth and estate planning. Our research shows that 75 percent of respondents failed to institute a personal financial plan before the IPO.

Timing is everything. After the IPO, the company's assets will have greater value; thus, it behooves executives to plan ahead. You have an

EXHIBIT 1.4. Company mergers and acquisitions that failed to equal cost of capital.

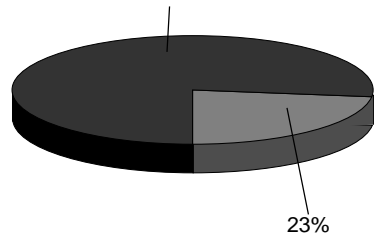
50% of major mergers since 1990 have eroded shareholder returns.

17% have contributed significant value.



Source: *Business Week*, October 1995.

77% of acquisitions do not earn or exceed their cost of capital.



Source: *Fortune*, November 1996.

opportunity to create and to transfer wealth, and this opportunity will be diminished substantially by waiting until the eve of a transaction. Neglecting your own financial planning can and does become a source of difficulty in the future. In federal estate taxes alone, the cost of waiting can amount to 55 cents on a dollar.

Create the Winning Team

A public company requires the strongest internal and external teams that it can assemble. Research clearly shows that market analysts and portfolio managers devote considerable attention to the quality of management. Does your present team have the breadth and depth to offer you the support you will need? This is the time to implement performance-measurement systems and to align them with the criteria of analysts who follow your industry. It is also the time to review your compensation plans for key employees so that they are rewarded for achieving your corporate performance goals, profiting from the company's success.

The sooner you choose an underwriter, the better. This person is your major link with the financial community, and it is vital that he or she become an advocate for your company. Remember, however, that the underwriter also represents the interests of investors.

It is also important to choose professional business advisors, including accountants and attorneys with substantial experience in the public capital markets, as well as at least two outside directors. If your outside directors

know you and your company well, they can give you advice that is likely to strengthen your position.

Complete Your IPO Platform

As a company begins to move out of the planning phase and into the execution phase of the Value Journey, CEOs often make the common mistake of beginning to execute their IPO before their company is ready. This is a time to determine whether all the building blocks are in place. Particularly important is considering the improvement agenda that you charted in your business strategy: What are you going to do with the funds you raise in the IPO and how can you communicate this purpose to your institutional investors? The best IPOs are made because of a compelling need for the capital. (At this point, many companies decide that they can meet their definition of success by a sale—or by some other transaction—rather than an IPO.)

Be the Public Company

The time to learn how to act like a public company is before the IPO. Otherwise, your good intentions may last for only one quarter. Acting like a public company involves managing the expectations of investors, which, in turn, depends on the accuracy of the forecasts in your business plan. The ability to forecast earnings accurately every quarter is critical to a successful public company. The public market is not the place to learn this process. You also have to learn to communicate regularly and strategically with all key stakeholders.

Let a research analyst from your investment bank help you find out which companies the market will regard as comparable to yours so you can use them as benchmarks. Finally, during the period just before the public offering, make sure your capital structure can withstand the inevitable surprises that occur in the public markets.

The IPO Event

A major challenge to the CEO is the 90-to-120-day period when you tell your story to the world in your IPO prospectus and road show.

Prospective investors and potential members of the underwriting syndicate will be looking directly to you and your senior management team for the company's story. There will be many internal and external demands. You will need to control the process, managing whatever conflicts might arise—and manage your business at the same time.

It is particularly important that all your senior executives articulate a consistent story. The market will consider any internal inconsistencies as a strike against management. Communication skills are key because this is the time to build credibility. It will be helpful to establish a structure for clearing all communications through a central source.

Deliver the Value

The IPO event is only the beginning. You have made promises to many different stakeholders, including investors, analysts, employees, customers, and the board. Now is the time to meet those expectations, and preferably to exceed them—quarter after quarter. Keep in mind that many investors have a very short attention span. It is not easy to recover if you miss your forecast even for one quarter.

Your challenge is to continue to execute your business plan, just as you did when you were a private company. At the same time, you have to manage investors, whose definition of *long-term* is, “What are you going to do in the next quarter?”

Renew and Re-create

Mike Bigham, CEO of Coulter Pharmaceuticals, has compared this leadership challenge to reaching the summit of a steep hill and then finding Mount Everest on the other side. Not only must you maintain the momentum you have achieved and continue to exceed market expectations, you also must update your vision, create a new set of milestones, and remain innovative and fast growing. Consider yourself to be back at the beginning of the Value Journey, updating your goals and strategic plan and continuing to accelerate, while also building the infrastructure and management practices that a mature public company requires.

NEXT STEPS

In this chapter, we outlined the key findings of our research concerning the characteristics that distinguish highly successful companies. The results clearly show that the most successful companies regard their IPO as part of a long-term process. Accordingly, this book takes as its starting point the perspective of the IPO as a critical event in a larger process that we call the Value Journey.

We have briefly described the major leadership challenges that CEOs face when they embark on an IPO journey. In the next chapter, *The Journey's Early, Vital Steps*, we will consider in greater detail some of the leadership challenges that typically occur in the planning stage of the Value Journey.