

## Consultation Paper: Going public – a director’s guide

**17 November 2014**

A public offering is a transformational event for an organisation. The process of preparing for, becoming, and being a public issuer can bring both opportunities and associated challenges. A company will face new requirements as a public issuer and this may require new skill sets, additional resources and changes to the business to meet these requirements.

Before deciding to go public, a company should consider whether it is at an appropriate stage to benefit from public financing. Consideration should also be given to what the new environment might look like, and the specific changes that will be required to get there. This level of consideration in advance of the public offering is essential. It will enable a smooth offering process and minimise the risk of unexpected post-IPO issues.

The number of companies looking to access the equity markets continues to grow. This guide will assist directors to assess their company’s circumstances and provide an insight into the process of becoming a public company. It should be read alongside the handbook ‘Corporate Governance in New Zealand: Principles and Guidelines’ which is a resource for directors, executives and advisers to help them understand what is expected of them more generally in their governance roles.

We hope you find it useful.

**Note: submissions close on 8<sup>th</sup> December 2014**

## What is a public offering?

An initial public offering (IPO) is a process through which a company's shares are first offered to the public with the intention of subsequently listing the shares on a licensed market. While this guide focuses on this IPO process, it will also be relevant for companies undertaking a 'compliance listing' on a licensed market, where no new capital is raised but the company's existing shares are listed then traded.

## Questions to ask

1. In this guide we outline six important questions for directors of a prospective issuer to think about as they prepare their company for market. Directors should consider:

Do I understand the company's business?

Is the board doing its job?

Have we chosen the right advisers and do I understand their roles?

Are we giving investors the right information?

Is the price right?

Do I understand the impact going public will have on the company?

2. The decision to go public and the timing of going public are important strategic considerations that should be made in the context of a well-developed business plan.

## Do I understand the company's business?

3. A director taking a company to market needs to ensure they understand the company's business. This understanding is essential so that directors can assure themselves of the quality and integrity of information provided to prospective investors.
4. Some important factors will include whether the company has:
  - a) an attractive product or service offering with a competitive advantage and a sufficiently large market
  - b) an experienced, capable and committed leadership team
  - c) a positive trend of historical financial results and/or compelling financial prospects
  - d) a well-developed and focused business plan
  - e) strong financial, operational and compliance controls
  - f) a sound risk management framework that enables it to identify the key risks impacting its business.
5. We encourage directors to spend a reasonable period of time in their role as director, to fully assess these, and other factors, ahead of an IPO. These factors should also be considered during any pre-appointment due diligence for any potential directorship appointment. We expect directors who

receive invitations to join the board of a company close to listing to exercise particular caution in ensuring they have adequately assessed the risks and challenges inherent in the company's business model.

6. Companies thinking about listing should consider well in advance of the IPO whether additional directors, with new or different skill sets, are needed to strengthen the board. Experience with the company will allow new directors to become familiar with the usual business of the company before focusing on the IPO process.

### Is the board doing its job?

7. The board's purpose is to lead the long-term success of the company.
8. When considering how effectively the board is doing its job, directors should consider whether the board and its members:
  - a) have the right balance of skills, experience, independence and knowledge of the company to enable them to govern well in the new environment
  - b) regularly review their performance and are committed to continuous improvement
  - c) set high standards of ethical behaviour, role model that behaviour and hold management accountable for delivering it throughout the organisation
  - d) understand the key risks the business faces and the steps being taken to address those risks, ensuring that rigorous risk management processes are implemented throughout the business
  - e) have established board committees (depending on the size of the business) such as an audit and risk committee and a nominations committee which are chaired by independent directors
  - f) are aware of, and are applying, the principles set out in the Corporate Governance Handbook.
9. It may take some time for you to feel confident that your board has the skills, expertise and competency to take the company to market.

### Have we chosen the right advisers and do I understand their roles?

10. Advisers and other service providers will play an important role in helping bring the company to market. However, the responsibility for decision making remains with the board, not with advisers, and it is important to understand your respective roles.

#### Key advisers and service providers

- a) **The management team.** It is important to understand the level of time and commitment a public offering will require from the company's staff and the depth of knowledge they must have about the company to help you prepare the company for market. This preparation needs to take place while also continuing to run the business as usual. You may need to supplement business as usual staffing to release key resources to work on the offer. This approach will ensure the quality and integrity of information prepared for investors.

- b) **Lead managers.** They will help you assess the marketability of the company, advise you on preparing the business for listing and manage the marketing and sale of the shares to public investors. They will also play a key role in helping the company set the price at which the shares will be sold. However, the board is responsible for the decision on pricing, and it is one of the key decisions the board needs to make.
- c) **The legal adviser.** Technical ability is important. Your legal adviser must be able to evaluate large amounts of information quickly and efficiently, and must represent your interests robustly in negotiations with other parties. Most importantly, your legal adviser must:
  - I. be able to explain the due diligence, public offer and listing process to you
  - II. be able to advise you on what your obligations are at the various stages of the process – pre-offer, during the offer period and once listed
  - III. understand and be able to explain the FMA's expectations of financial markets participants, so they can help you comply with current laws and requirements
  - IV. help you explain the offer in your offer documents in a clear, concise and effective way that helps investors to make sound investment decisions.
- d) **The auditor.** Your auditor should have been appointed well in advance of the IPO, so that any accounting and financial reporting issues have been resolved long before the offer process begins. As well as being technically competent, your auditor should also be able to explain complex financial issues. The auditor should help you to explain any issues to investors in a clear, concise and effective way.
- e) **The advisory accountant.** Your accountant will help you resolve complex technical issues in relation to financial reporting and financial strategy. Like the auditor, your advisory accountant should be able to explain complex issues to you in a clear, concise and effective way.

While technical competence and market experience is important, if an adviser can't explain what's going on in terms you can understand, then consider finding another adviser.

## Are we giving investors the right information?

11. An issuer must provide prospective investors with the information they need to make a sound investment decision. Under current securities laws, this means preparing a prospectus and investment statement that contains information required by law, and written in a way that is not misleading or deceptive.
12. From 1 December 2014, new offer information requirements will mean potential investors will receive a short Product Disclosure Statement (PDS) with a key information summary containing the most important information they need to make an investment decision. The PDS will replace the current investment statement and prospectus. Directors have an obligation to prepare and present the information in their PDS in a clear, concise and effective manner and must ensure the PDS is not

false or misleading. Other material information not already included in the PDS must be lodged on an online register. This information must be kept up to date during the term of the offer.

13. We encourage you to ask yourself how you know the information the company is providing is true and complete. Does it clearly provide the information investors need to make sound investment decisions? The quality and integrity of information provided to prospective investors is key to ensuring investors make sound and informed investment decisions. Directors must make all reasonable enquiries, and take all reasonable and proper steps, to ensure the issuer has complied with its obligations to provide the necessary information to prospective investors.

### The importance of a due diligence process

14. We expect directors to ensure the company has robust processes for verifying the information provided to investors. A due diligence process, designed and implemented with this verification objective in mind, will more effectively protect directors from legal liability than a process designed with director or adviser liability in mind.
15. The due diligence process needs to involve the people who have knowledge of the company, its business and the offer process. Their job is to ensure that the information provided to investors is true, complete, is not misleading and meets regulatory requirements. It is common practice to constitute a due diligence committee to oversee this process and for advisers to document how this committee will operate, including the roles and responsibilities of committee members. The committee will usually involve key members of company management and key advisers.
  - a) **Key members of company management.** This category should include the chief executive and chief financial officer, and also other senior staff who have sufficient knowledge. This group should ensure the right information is provided about the company and its business. This applies not only to each individual statement made in the offer documents and register, but to the information provided when viewed as a whole.
  - b) **Key advisers.** This group should include a representative of the lead manager/s, the company's auditor and the legal adviser - each who have sufficient oversight of the offer structure and process. This group oversees the preparation and verification of information to be included in the offer documents and on the register.
16. Membership of the due diligence committee should be based on the ability to supervise preparation of offer information meeting the required standards. In short, offer information should enable investors and the market to assess both the issuer and the offer, and to then make informed investment decisions.
17. Any distinction between those who are members of the due diligence committee, those who attend the due diligence committee as observers or advisers, and those who have had no formal role in the due diligence committee or process, is largely artificial. The substance and clarity of the role of each individual in the process is more important. We therefore encourage directors to satisfy themselves that their due diligence committees have the right mix of skills and expertise, and that the processes are robust and able to be relied upon.
18. Being a member of the due diligence committee does not mean that you have increased your liability for the offer document. Rather, it shows that you have taken the lead in ensuring that

investors receive the information they need. The level of director involvement in any IPO process will depend on the circumstances of the offer.

19. For offers such as IPOs that fall outside business as usual, we expect directors will take a more active role in reviewing and approving the offer information, and ensuring they are satisfied that the preparation process has been adequate.
20. We acknowledge and understand that errors will sometimes occur in the information provided to prospective investors. We will take a balanced and pragmatic regulatory approach to issuers and their directors who make mistakes despite having made genuine, competent attempts in good faith to ensure the information they provide is true, complete and meets regulatory requirements.
21. Ultimately, directors and companies who place their own interests ahead of those of investors, who design a due diligence process to protect themselves or their advisers, or who decide not to co-operate with the FMA (or to co-operate at a minimalist level) can expect a robust regulatory response.

### Is the price right?

22. One of the key decisions you will need to make is the price at which the shares will be issued. This is fundamental to the success or failure of your IPO.
23. The lead manager will likely have carried out a 'book build' process to estimate the level of institutional investor interest in buying the shares, and will recommend a price based on that level of interest. However, as a director you must set the price at which the shares will be issued, and satisfy yourself that it is fair and reasonable to the company and to existing and prospective shareholders.
24. In doing so, you must take into account all relevant factors – the price potential institutional investors are prepared to pay through the 'book build' is only one factor. Another main factor to consider is whether the price appropriately reflects the value of the company and its assets today. Ask yourself if it sets a fair and sustainable platform for its value for the future and any subsequent capital raisings

### Do I understand the impact going public will have on the company?

25. The IPO is not the end of the company's journey as a listed company - it is only the beginning. Once listed, a company will:
  - a) be under far greater public scrutiny
  - b) have a new set of stakeholder relationships, including with public shareholders, media, analysts and regulators
  - c) have a range of continuing obligations to comply with.

26. The way the company goes about managing these relationships and obligations will have a real and enduring impact on its reputation and value. We encourage directors of listed issuers to set the appropriate tone across the organisation and to:

- a) understand the standards of behaviour expected by the law and by the FMA, and to hold management accountable for delivering those standards
- b) give appropriate weight to the interests of customers and shareholders in all decision making
- c) hold management accountable for raising organisational compliance standards above the bare minimum.

In our view, building a viable and sustainable business by placing key stakeholders at the forefront of a company's operations is consistent with a director's duty to act in the best interests of the company.

## Submissions

If you'd like to make a submission on any of the aspects discussed, or if you have another question or comment, please use the form at the end of this document. Email the form to [consultation@fma.govt.nz](mailto:consultation@fma.govt.nz).

If you have questions about the consultation process, please contact:

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## Feedback: Going Public – A director’s guide

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at [consultation@fma.govt.nz](mailto:consultation@fma.govt.nz) with ‘Feedback: Going Public – A director’s guide’ in the subject line. Thank you. **Submissions close on 8<sup>th</sup> December 2014**

Date: \_\_\_\_\_ Number of pages: \_\_\_\_\_

Name of submitter: \_\_\_\_\_

Company or entity: \_\_\_\_\_

Organisation type: \_\_\_\_\_

Contact name (if different): \_\_\_\_\_

Contact email and Phone: \_\_\_\_\_

Para or Q #	Comment	Recommendation

**Feedback Summary** – *if you wish to highlight anything in particular*

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**Thank you for your feedback – we appreciate your time and input.**