Cracking the Growth Code:

Turning Challenge Into Opportunity

Audit / Tax / Advisory / Risk / Performance

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Introduction

High-growth technology companies face an array of challenges as they navigate toward the next stage of their development. Whether expanding globally, introducing new products, raising money, or positioning the company for sale or growth through acquisition, getting the right advice on tax and financial reporting matters is critical.

So much of business growth relies on executing well and paying attention to details. This is especially true when it comes to tax planning and financial reporting, where this level of attention can pay real dividends. Financial statements are the company's calling card to investors, potential merger or acquisition partners, customers, and other key stakeholders. It is essential that statements are well-prepared, assessed by an independent audit firm, and reflect the true state of the company. Although taxes are inevitable, smart and proactive tax planning can help high-growth technology companies maximize tax efficiency and use it to their advantage.

A smart approach to tax planning and financial reporting can provide executives with more options to consider as they focus on growth and creating a more stable company and business. Such an approach can yield benefits in many areas, like maximizing the value of the compensation packages for executives and other key talent.

When it comes to taking the company to the next level, a strong tax planning and financial reporting structure can support fundraising or merger and acquisition (M&A) activity, speed up M&A execution, and yield a faster close on financing.

The result is a structure and approach that can support executives – whether they are working in their first growth company or they have experienced the situation many times before. This e-book focuses on five areas where effective tax planning and financial reporting strategies can make a difference in the success of high-growth technology companies.

Executive Compensation

Finding effective and tax-efficient ways to reward and create incentives for top executives is one of the most important challenges high-growth companies face. These companies may find that key executive talent is concentrated in a small number of individuals. The companies also may not yet have the resources to compete with the compensation packages offered by larger companies. At the same time, these programs should be both well-designed and able to withstand a great deal of scrutiny as regulators, investors, and the executives themselves closely monitor these packages, including what they reward and how they perform.

High-growth companies should design executive pay programs that will make the most of available resources, adhere to regulatory requirements, and manage tax issues for both the company and the executive involved. This last element is critical. Many companies do not consider the tax consequences for various pay structures and compensation packages. Instead, they focus on simply developing a competitive package. However, being competitive and maximizing tax efficiency are not mutually exclusive when companies take a proactive and strategic approach to the design of executive compensation.

Consider the issue of equity. Equity is a given for publicly traded companies, often in the form of stock options. However, creating equity or equity-like compensation plans is more complex for high-growth companies that are not yet publicly traded and may not be for some time. For these private companies, other vehicles may make more sense and create a better incentive for executives. For example, a company could develop performance-based plans that trigger payouts based on achieving certain financial results or achieving a specific event, like an IPO or sale of the company. These triggers have the added benefit of keeping compensation value off the financial statements until the specific triggering event becomes probable of occurring. Phantom stock and stock appreciation rights (SARs) are two other options for private companies.

No matter what vehicle a company chooses for the executive compensation plan, the overall plan design is key. Everything from specific performance goals to the time frame for measuring results and vesting schedules should be carefully considered and planned. Questions about whether to allow executive contributions to the plan or to keep it completely employer-provided is another important question. This approach should apply to all benefits, including deferred compensation, vacation, retirement plans.

This is also the time to consider the tax implications of each plan element from the executive's perspective. It can make sense to help executives understand when they will incur taxable income under these plans and what they can do to manage these tax events. In some cases, companies may evaluate various compensation vehicles based on whether executives will be able to manage or delay when those payouts are taxed.

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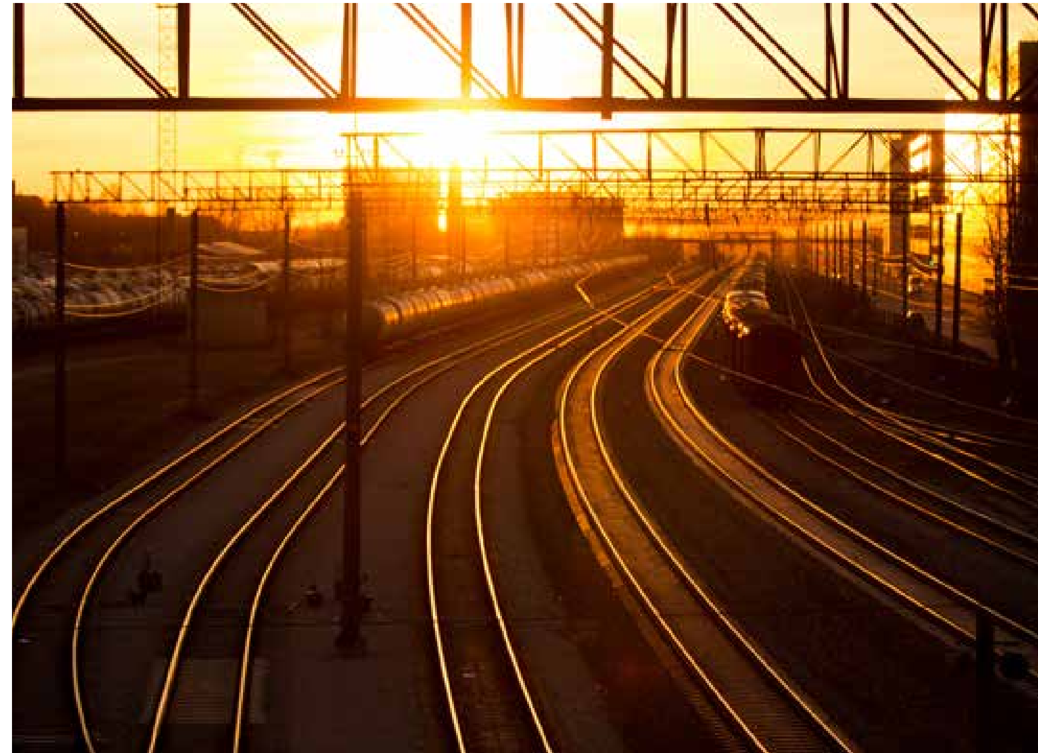
Talent Management

Attracting, retaining, and managing nonexecutive talent is another essential element of success for high-growth technology companies. Like executive talent, the appropriate people necessary to help grow a strong technology company are relatively scarce. Therefore, high-growth companies should carefully build on available resources to remain competitive in the marketplace.

To do this well, companies should develop an overall compensation philosophy to guide the design, development, and administration of employee compensation programs. This philosophy should cover the basics, such as where to peg salary levels – at, below, or above the median, as set by competitive market data. Such parameters establish that the company will be using appropriate data consistently when identifying appropriate pay at each level and for each job.

Competitive data should also play a role in the design of employee benefit plans. In this case, design decisions can be based on comparisons by industry, geography, or any other relevant benchmarks. Throughout this process, there should be a clear focus on critical design elements, including the level of required employee contributions to medical coverage and the size of employer retirement plan contributions.



Changing Business Models and Accounting Standards

Change is a constant in the technology industry, as innovation soars and new business models take hold. Outside the business, changing accounting standards can have a substantial impact on high-growth technology companies. For example, adopting the new accounting standards for revenue recognition has posed a challenge for high-growth companies due to the resources required to evaluate the impact and develop an implementation strategy.

Many high-growth companies have had to adjust their customer acquisition strategies in response to recent changes in revenue recognition requirements. These companies should carefully consider the implications of revenue recognition requirements for product bundling, different pricing structures, and embedded discounts. Depending on how these elements are structured, revenue recognition requirements can have a significant impact on the value of the allocation of deliverables and the entire customer relationship.

Contract language is also important and company executives should always understand how each contract they sign could affect their financial statements, both immediately and long-term. The exact wording of contract terms can affect when and how a company can recognize the resulting revenue on its financial statements. In many cases, revenue recognition is not related to a company's cash flow. Therefore, high-growth technology companies should find the right balance in contract terms that will provide cash flow to keep the business going, while also recognizing revenue from an accounting perspective that will meet the needs of the company in terms of its financial results.

For example, a company that is migrating from a licensed software business model to a business model focused on offering software as a service (SaaS) faces the challenge of creating recurring monthly revenue with cloud software subscriptions. The approach and structure of the contracts will have a significant impact on revenue recognition and taxes. Unless a company understands the complexity of how it structures sales and recognizes revenue, new growth could create confusion and potential short- and long-term problems on a number of fronts.

For example, improperly recognized revenue could lead to incorrect information on financial statements. If a company is trying to attract funding from investors or lenders, the resulting confusion could lead to delays in the process. Ultimately, this confusion and lack of revenue clarity could affect the company's value when it comes to financing, mergers, acquisitions, or other transactions.

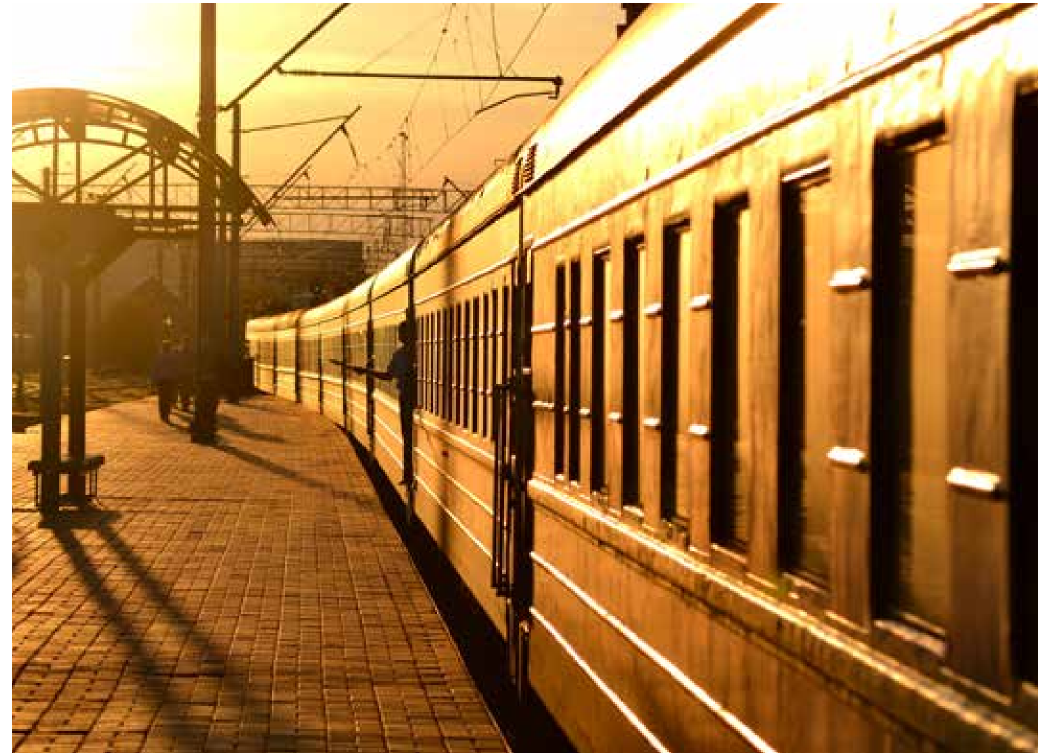
To avoid these issues, high-growth technology companies should take a proactive approach that helps create a clear picture of the company performance for all interested parties. In addition to maximizing the company's value and management credibility, this approach can help avoid the expense and confusion associated with addressing or correcting these issues after the fact.

Global Growth

Global expansion is a vital part of the growth trajectory for high-growth technology companies. Deciding to sell products or set up operations in another country or region is just the first step. Every subsequent decision should have a broad enough perspective to enable the company to maximize the tax efficiency of operational and management decision-making and manage its impact on financial statements and financial reporting.

This process begins with an appropriate structure for the global part of the business – independent entity, subsidiary, division, or some other option. From there, executives should consider how to manage the entire business from a global perspective, including supply chains, moving money across borders, identifying transfer pricing opportunities, deferring income, and considering the impacts of relevant tax treaties and value-added tax structures.

No matter how well executives understand the business, global operations involve an array of moving parts that will affect business results, revenue, profit, expenses, and many other short- and long-term issues. Therefore, it is important to understand and manage the risks associated with global operations, including different cultures and business practices worldwide. Actions that might be commonplace and readily accepted in some countries could cause compliance trouble with anti-corruption laws, such as the *Foreign Corrupt Practices Act* (FCPA) in the U.S. Even if certain actions do not rise to the level of corruption, routine audits can determine, for example, whether sales teams are engaging in common local practices with customers and distributors that undermine overall accountability within global operations.



Due Diligence in Mergers and Acquisitions

The process of maximizing the value of a merger or acquisition begins well before any discussion of the transaction, whether a company is the buyer or the seller. If a company is pursuing acquisitions as part of its growth strategy, executives should make sure due diligence capabilities are available either through internal resources or external expertise. These teams should closely vet the target company's technology and overall capabilities, so that the buying company understands the target company's full value when determining what it is willing to pay for it.

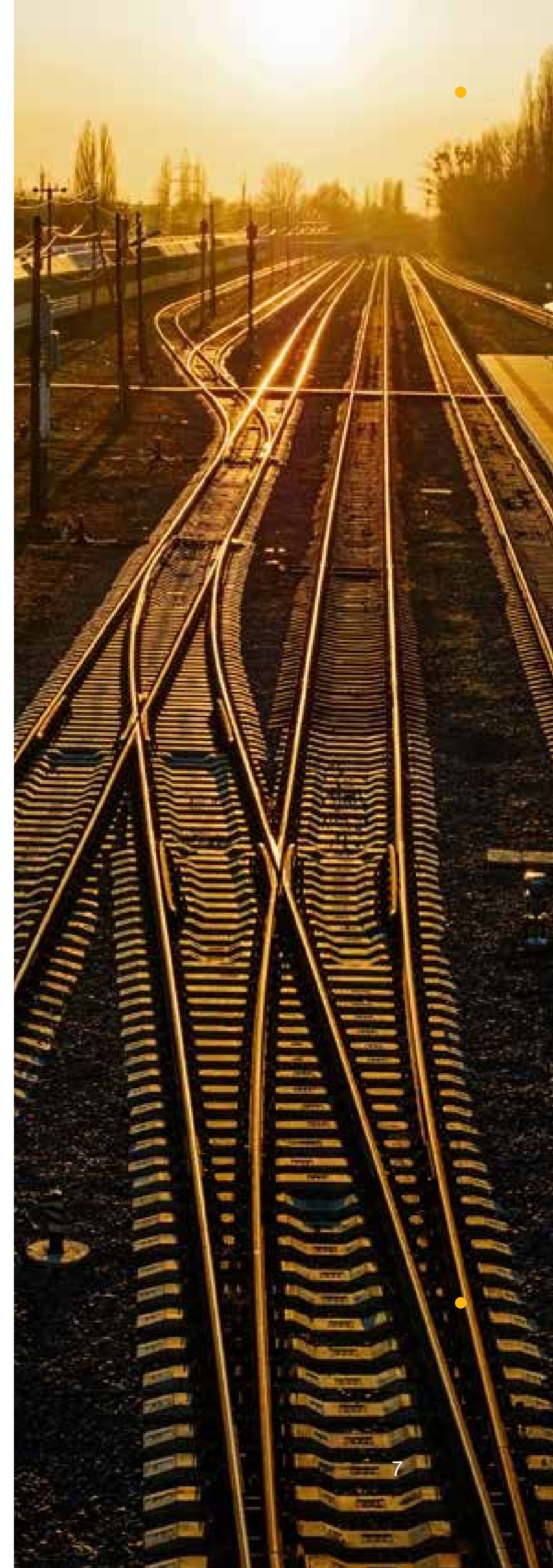
Financial due diligence includes a review of the target company's customer contracts, a close examination of booked accounts receivable, and the tax attributes of the target company. This is also the time to find out if the target company has a history of lawsuits or has any legal actions pending, including the size of any resulting or potential liabilities.

With this information, the buying company can settle on a purchase price. At this point, the company should consider how the purchase price will be allocated and the timing of the payments. If the deal involves stock, this is the time to determine if there will be any issues related to the stock of the target company.

Finally, before entering the transaction, the buying company should test its internal controls to determine that they will not be unduly stressed and will work as intended during the post-deal transition. Acquisitions involve many different moving parts, so management should be sure that it understands and is able to monitor all elements of the transaction – not only through the closing of the deal, but during the transition to the combined company.

When positioning their own company for sale, executives should work carefully to get everything in order before talking to potential buyers. This means conducting audits of their own operations and evaluating tax structures to identify problem areas. When done well, this process can help selling companies identify and address problems and weaknesses, and make a clear-eyed assessment of the company's value before trying to attract a buyer. This is especially important when problem areas could adversely affect the purchase price.

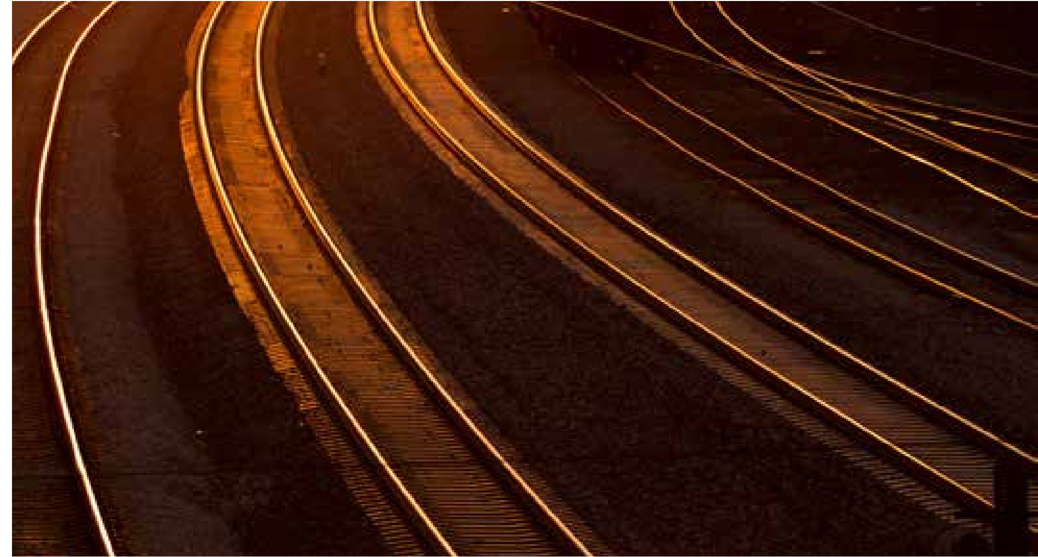
When working with a potential buyer, it is important to set realistic expectations for how quickly the deal can close and what that will involve. This type of planning can help to reduce the amount of time necessary to close the deal. To hasten the process, the target company should be ready to comply with buyer due diligence requests quickly and thoroughly.



Conclusion

Proactive and strategic action is essential to high-growth technology companies. Companies that are not prepared to act in the five areas described in this e-book could end up with costly and complex problems. In some situations, these problems could fester and affect a company's ability to get full value for the business, whether through sale or IPO.

At its best, proactive management in these areas can yield significant benefits through smart tax planning, strong growth strategies, clear-headed risk management, and the ability to address emerging issues quickly. Together these actions can create an easier and faster transaction when selling the company, or a strong foundation for continued growth.



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