STARTUP BOARDS

STARTUP REVOLUTION

GETTING THE MOST OUT OF YOUR BOARD OF DIRECTORS

BRAD FELD MAHENDRA RAMSINGHANI

WILEY

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GETTING THE MOST OUT OF YOUR BOARD OF DIRECTORS

BRAD FELD
MAHENDRA RAMSINGHANI

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Foreword

The phone rang at the appointed hour. My client, a software company CEO, was calling for his regul session. I picked up the phone.

“Hello”

“Why the hell does my board act like that?”

“Good morning, James,” I answered and we both laughed.

We talked through the upcoming financing. Some of the investors—folks who came into th company only in the last round—were already jockeying around terms and prices of the upcomin round. Some of the other directors—investors who had been with the company since the beginning- were also beginning to draw a hard line around terms that they would find acceptable.

In a sense, while they were all directors, as investors they were beginning to play a game of chicke with the company’s financing—each holding fast to a position deemed best for the shareholders the represent and yet, as the negotiations ticked on, the company’s ability to actually raise the neede funds could be jeopardized.

After the session, I asked him if I could quote him.

“Sure,” he said, “just let me know if I ever end up with an actual video recording of me calling [th board member] a ‘fuckhead’—it’s not that I’d be bothered by that, it’s just that I’d want to make su I sent the link to all my friends.”

A year ago I was sitting in the office of the CEO of a company on whose board I served. Th recently elected chair and the CEO were screaming at each other and, as usual, I found myself tryin to mediate.

“What you don’t understand,” said the chair rising from his chair and trying to tower over the seate CEO, “is that you’re here,” and he held out his right hand, palm down, “and the board is here,” and l moved his left hand on top of the right, again palm down, “and I’m here,” and he placed his right han over the left.

Capo dei capi—boss of bosses.

My client’s question was spot on: Why does this happen? What is it that makes the relationsh among board members, investors, and management so tricky? And even when you remove the notio of director as investor (or investor representative) you can still end up with troubled relations.

The board/management relationship is tricky, complex, and nuanced. There are few structure within traditional businesses that are quite like it. Most businesses, indeed most organizations, a built on some variation of a command-and-control structure. Because of their inherent hierarchic nature, it’s often clear who’s in charge, who makes the decisions, and who’s ultimately responsible fo what.

Even in businesses where the power and decision making reflects not the pyramid of class command and control but the inverted pyramid of the ways in which information and therefo accountability should flow, there’s relative clarity.

But when it comes to boards of directors, confusion is often the norm and, as a result, there accompanying frustration and anger. For example, does the CEO work for the board of directors or th company? Does the board “work” for the company? Who holds individual board members accountab for their actions? What is the relationship between board and staff members?

Underlying all of this is the responsibility to represent the shareholders.

I’ve served on dozens of boards of directors—this includes public and private companies, for-prof ~~businesses, and not-for-profit organizations. I think the core troubles stem from a misunderstanding~~ the key elements of the roles.

Directors aren’t quite like any other management position in an organization. They have power b often lack the information to wield that power as well as managers. They have perspective—ofte significantly more experience than senior management—but, by the nature of their responsibility, the are disconnected from the day-to-day operations.

Directors need to remember they have a delicate balancing act of influencing without dictating, ar engaging and sharing their experience and perspective by virtue of their gravitas as much as a result their power.

Management, too, needs to remember that the task of being a director or a trustee is unlike any oth job one has ever had. There’s an explicit accountability that goes along with the job, and that fac combined with the implicit lack of information, can cause most folks to feel terribly anxious and act in awful ways.

This book by Brad Feld and Mahendra Ramsinghani will help everyone on both sides of that divid to take a needed step back, see things from the other view, and work toward making the board functional as possible.

JERRY COLONN

Life and Business Coac
Retired Venture Capitali
Chair, Naropa Universi

Acknowledgments

The original inspiration for the Startup Revolution series came from a conversation we had sever years ago. Mahendra and Brad met briefly in person in Ann Arbor at an event that Brad and his partn Jason Mendelson held for *Venture Deals: Be Smarter than Your Lawyer and Venture Capitalis* Mahendra followed up a few days later with an e-mail suggesting that we write a book about boards directors together. A year later, a five-book series was launched, with *Startup Boards* as book numb four.

This has been a challenging book to write. Both of us worked hard to cover a lot of territory, bo traditional and non-traditional, without putting ourselves, and you, to sleep. We'll let you be the judg of whether we achieved this and, if you are napping, we hope you are in a comfortable position.

Many people have contributed to this book. We appreciate all the efforts, interviews, and writin from Micah Baldwin, Scott Bannister, Jacques Benkoski, Paul Berberian, Rajat Bhargava, Stev Blank, Matt Blumberg, Tom Bogan, Jeff Bussgang, Jon Callaghan, Dane Collins, Jim Dai, Gre Gottesman, Chris Heidelberger, Will Herman, Ben Horowitz, Richard Huston, Eric Jensen, Jos Kopelman, Clint Korver, Manu Kumar, Wendy Lea, Aileen Lee, Seth Levine, Scott Maxwell, T. A McCann, Kelly McCracken, Ryan McIntyre, Jason Mendelson, Lesa Mitchell, Cindy Padnos, Mik Platt, Thomas Porter, Andy Rappaport, Christopher Rizik, Niel Robertson, Adam Rodnitzsky, Heid Roizen, William Ruckelshaus, Lucy Sanders, Greg Sands, Zachary Shulman, Mike Smalls, Mar Solon, Mark Suster, Shanna Tellerman, Steven Tonsfeldt, Sreeram Veeragandham, Todd Vernon Noam Wasserman, Scott Weiss, and Fred Wilson.

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Once again, Brad's wife Amy Batchelor took out her red pen and did a great editing job on sever early drafts. At a key moment in time, Jason read an early draft and helped us restructure it so it wa much better. Amy also put up with a week-long trip to Miami where we hung out at the W Hotel an mostly procrastinated, which we have learned is an integral part of the writing process.

Part One

Overview

Chapter One

Introduction

The word *boardroom* conjures up images of important people puffing on cigars or sipping Scotc while sitting in leather chairs in wood-paneled rooms. These important people are talking abo complex things that determine the future of companies. Formality and seriousness fill the air. B decisions are being made.

While first-time chief executive officers (CEOs) and founders often have an elevated view of th boardroom, great startup boards aren't fancy, complex, or pretentious. Instead, a startup board usually a small group of people trying to help build your company.

Over the years, we've served on hundreds of boards. A few were great, many were good, and som were terrible. When things in a company were going smoothly, the board was congratulatory an supportive. When there were challenges, some boards helped and some boards hurt. The tempo an interactions of these boards varied dramatically. In some cases reality prevailed, and in others it wa denied.

In 2010, after a particularly tedious board meeting, Brad realized that the default structure of startup board was an artifact of the past 40 years, dating back to the way early venture-backe company boards operated. Things had changed and evolved some, but the dramatic shift communication patterns and technology over the past decade hadn't been incorporated into the wa most boards worked. As a result, Brad ran a two-year experiment where he tried different things; som successful, some not. As with every experiment, he did more of what worked, modified and kille what didn't, tried new things, and measured a lot of stuff.

The idea for this book emerged during this experiment. We decided that in addition to describing th new startup board approach that resulted from Brad's experiment, it was important to lay th groundwork and explain clearly how startup boards worked, how they could be most effective, an what the challenges were. Brad's new board approach built on the traditional board of directors, s rather than throw it out, we use a highly functioning one as the basis for a new, evolved, and muc more effective approach to a board of directors.

While the topic may feel dry, we've tried, as Brad and Jason Mendelson (Foundry Group, Managin Director) did in *Venture Deals: Be Smarter Than Your Lawyer and Venture Capitalist* , to take serious topic, cover it rigorously, but do it in plain English with our own brand of humor. Our goal to demystify how a board of directors works, discuss historical best and worst practices, and give yo a clear set of tools for creating and managing an awesome board.

Why Does a Startup Need a Board?

Entrepreneurs, the creators and architects of creative construction (with apologies to Schumpeter[1] enjoy creating new products and companies from just an idea. These forceful personalities break ne ground and explore uncharted territory while their unstoppable drive changes the world we live in. A a society, we should be grateful to the entrepreneurial force that creates new things, but often th new-new thing causes fear and uncertainty in the old and the established, followed by resistance ar denial. Whether it is building a new product, landing the first customer, raising the initial round c capital, or recruiting early team members, an entrepreneur's journey can be lonely, stressful, ar extremely challenging. While entrepreneurship currently is popular—even trendy—this is not alway the case, and the journey to create a successful company can be a long and difficult one.

One of the early challenges encountered is raising money. While many startups are bootstrappe with the founders choosing to focus on generating revenue to fund their business, other entrepreneu choose to raise money from friends and family, angel investors, or venture capitalists (VCs). Th challenges of raising the first round of capital are well documented, and only a small percentage startups get funded, either through sheer persistence or a stroke of luck.

Once this first round of capital is raised, a new set of challenges arises. Investors, driven by th desire for a substantial financial return, seek milestones, demonstrable progress, new rounds financing at higher prices, or even quick exits. While some investors may be patient, taking a decac or longer view to helping build the company, others are more anxious to see quick progress. In mar cases, these investors view the company as partly their own, which it in fact is, now that they'v invested in it. Some of these investors are happy to support the entrepreneur in any way th entrepreneur needs them to. Other investors have their own view of what they, and the entrepreneu should be doing—providing oversight, and "adding value" to the startup through their role on th board.

A long-standing cliché in the venture capital world is that VCs provide "adult supervision" to th entrepreneurs. We find this language to be pejorative and insulting to the entrepreneur and th company, so we try to avoid it. Instead of talking in abstractions, we'll describe clearly what VCs ar board members can do to be helpful to the companies whose boards they serve on. We'll be equall direct about describing what entrepreneurs and management can do to engage these directors.

A board of directors can be created at the inception of the company and is almost always formed conjunction with the first outside financing. Many early-stage companies never convene a board on regular basis. In bootstrapped companies, the entrepreneurs have no outside investors so they ofte feel no need to create a board since they feel responsible only to themselves.

In all cases we think this is a mistake and believe you should form your board early in the life your company, regardless of how you are financed. If you do it correctly, choose the right director and engage them actively, they can help you dramatically accelerate your business. Then when yo run into trouble, they can help guide you through the tough spots.

Clint Korver (Ulu Ventures, Partner) teaches a course on startup boards at Stanford Universit called "Startup Boards: Advanced Entrepreneurship." Clint says, "The most common mistake startup make is *not* having a board at all." He points out that research shows a majority of startups fail due self-inflicted wounds—internal decisions about founding team, roles, equity, and other importa issues. "Founders who are overconfident or choose to avoid conflict often miss an opportunity to brin in fresh perspective and structure these decisions from appropriate individuals," says Clint. "The oth common mistake founders make is to populate the board with friends and family—you need to thin carefully if they can address challenges or make decisions in the interest of the startup. Finally, ofte only founders populate the startups board—this often leads to confusion with respect to decisio making and authority.”

The Board Is an Extension of Your Team

The search for capital can be agonizing. When a term sheet is on the horizon, most founders a ecstatic that the long process of raising the venture round is almost over. During this process, mar founders ignore the type of board members that come with the money. Smart founders understand th building a great company is all about the people and the members of the board are just as important the early employees. “If I was prepping my younger brother on a startup journey, I would tell him raise money only from those investors who can strategically add value and emotionally connect wi you to help you be better,” says Foundry Group managing director Jason Mendelson.

Once you’ve taken investment from VCs, they will ensure their investment has some protection as result of control provisions in the financing document. They’ll also have a governance role as a resu of their board seat. But more importantly they become part of the company as a result of their role the board. While founders and investors often fret over control issues, Union Square Ventures partn Fred Wilson points out, “Boards should not be controlled by the founder, the CEO, or the large shareholder. For a board to do its job, it must represent all stakeholders’ interests, not just or stakeholder’s interest.”[2]

The best entrepreneurs construct a board of directors the same way they build their co management team, recruiting the best people they can find for the roles that are needed. A great boar member can be a superb coach and mentor—pushing you to grow, encouraging you to take on bigg challenges, and ultimately reaching your highest potential. Like any great coach, he will be caref never to undermine you or jump in the driver’s seat.

Not all board members understand this. Some feel the need to manage the CEO and th entrepreneurs. Others can’t help but get involved in minutiae stir up conflict, and try to solv problems that they see emerging. This type of board member behavior gets in the way of th functioning of the company, confuses the management team, and, in the worst cases, damages th startup.

Constructing a good board starts with identifying investors and board members who understand th world of startups, know the dynamics of your market, and bring unique positive attributes that a often much more important than money. Founders, especially early in the life of a company, often fe like they have to make trade-offs to take money when it’s available, rather than patiently seeking th right investor for their startup. Being patient is worth it—ultimately having the right personalities wi help make the journey of a startup CEO easier.

Boards can significantly impact the trajectory of a startup. A great board is a mix of intellec experience, personalities, ego, emotions, and aspirations that, when combined correctly, can be strong net positive experience for the company. It can be magical when a diverse set of experienc among board members—including product development, business strategy, financial expertis general management skills, and broad network reach—are joined effectively. In contrast, when th ingredients don’t mix well, it can be a disaster.

Your board is your inner sanctum and your strategic planning department.[3] The board guide engages regularly, and builds a deep relationship with the CEO. But it is not simply a friendship—th board expects results and accountability. Value creation is a cliché in a startup’s vocabulary, but if CEO ignores the goal of building a valuable business, boards, especially those loaded with investor will often turn against a CEO.

In this book, we’ll talk about how to construct the board, lead and manage it, and deal with conflic when they arise. We’ll also help you understand how to get the most out of your board and how t address things when they aren’t working. While a great board can be a guidepost and a positi catalyst, a bad board can cause angst and frustration, destroy value, and occasionally kill a compan Don’t ever forget the cliché “success results from the entrepreneur, failure belongs to the board.”

Who This Book Is For

Our goal with the books in the Startup Revolution series (http://startuprev.com) is to help ar entrepreneur, regardless of experience, location, or type of company. While we've written this boo with the first-time entrepreneur in mind, we believe each book in the series applies to entrepreneu with any level of experience. Having a "beginner's mind" often helps you learn new things. If you a an experienced entrepreneur, we hope this is one of those cases.

We've also written this book for board members. Over the past 20 years, we've encountered ar worked with thousands of board members covering a wide range of experiences. While a few of the board members were spectacular and had a dramatic, positive impact on the trajectory and outcome the company, many were average and had a neutral or insignificant impact. Others were detrimenta We've learned a lot from all of these experiences—both good and bad—and have tried to incorpora this learning into this book in a way that is helpful to any board member regardless of experience.

This book is also for management teams. Most management teams are directly exposed to the boa and interact with them on a regular basis. This can be extremely helpful or completely disruptive. Tl responsibility of a successful relationship between board members and members of the manageme team belongs to both the board members and the management team. As a result, we think ever executive in a startup company can benefit from this book.

Throughout this book we've incorporated the advice of many investors, board member entrepreneurs, and executives whose views we respect. We've used stories and examples th emphasize certain points. We give plenty of advice and provide tools for implementing this advic However, we are still learning, so we'll continue to write about our experience, new experiments, ar things we learn on the Startup Revolution web site at http://startuprev.com.

Magic Words, Phrases, and Abbreviations

Having written several books, we've come to learn how important it is to be precise with certa words and phrases. This book was particularly tricky given the different roles participants play in board, so we'll define a few right now. Our goal, as with everything we do, is inclusiveness, so yo should err on the side of a broader definition when you encounter a magic word, unless we speci otherwise.

Entrepreneur and *founder:* We use these two words interchangeably. To us, they mean the same thing.

CEO: The CEO can be one of the founders, but doesn't have to be. Occasionally, we'll refer to "founder/CEO" when this is an important distinction.

Angel investor: We include "friends and family" and "seed" investors in the definition of an "angel investor." So when you see "angel investor," you know we are talking about the early investors in a company who are investing their own money. We do not ever include "seed VCs" in this category, although the angel investors could be the seed investors.

VC: We often abbreviate "venture capitalist" as "VC." It takes the word count down significantly and is a lot more readable.

Board: We'll start abbreviating "board of directors" as "board." There's that word count thing again.

Chair: While "chairman of the board" sounds serious and weighty, there are plenty of "chairwomen." We prefer to use "chair" since it's gender neutral.

We've written this book together. While we each have a different set of experiences, we felt would be more effective to use one voice. We'll often refer to one of us in the third person; if you'v read the book *Startup Life: Surviving and Thriving with an Entrepreneur* that Brad wrote with h wife, Amy Batchelor, you are already used to this approach.

Okay, let's get started.

Notes

1. Joseph Schumpeter, an economist, coined the term *creative destruction* to describe the forces of entrepreneurship and innovation. Growth occurs out of the destruction of previous economic order. As Brad likes to say, creative construction is really what is happening.

2. Fred Wilson, www.avc.com/a_vc/2012/03/the-board-of-directors-role-and-responsibilities.html

3. Brad Feld and Jason Mendelson, *Venture Deals: Be Smarter Than Your Lawyer and Venture Capitalist* (Hoboken, NJ: Wiley, 2011), 61.

Chapter Two

What Is a Board?

Cooley LLP partner Eric Jensen, who represents companies like LinkedIn and Adobe, describe corporate governance as “processes, customs, policies, and laws affecting the way a corporation directed, administered, and controlled.” He goes on to say, “While local state laws are important, th right processes and policies are of equal or greater importance. Many companies just get going an assume that the right practices will develop.”

A board of directors has a set of formal duties, which are often referred to as *corporate governanc* They include legal concepts such as *duty of care* and *duty of loyalty* as well as committees such as th audit, compensation, and nominating committees. While startup boards should be nimble, it is usef to understand the formal requirements.

As a startup grows, the number of stakeholders increases. At the time of its inception, a startup ma have a small team, often just the founders. A few early employees are added and given stock option A seed round is completed, which adds a few angel investors. The company releases its produc customers and suppliers become stakeholders in the startup. More employees are added, and a ventu capital round is completed. Soon, you have a number of differing interests, some short term and son long term, related to the company. At times, these interests conflict with each other. The boar ultimately is responsible for navigating any conflicts that arise.

Rather than defaulting into whatever processes start to happen, excellent founders focus early o putting a structure in place to ensure that the board develops governance policies and procedures minimize conflicts of interest and maximize shareholder value. Good boards invite counsel participate in meetings to ensure that best practices are being followed. While entrepreneurs a rightfully concerned about racking up legal fees in such situations, Eric Jensen states, “Just as a VC focused on building the company using best practices, a good attorney does not focus just on leg aspects. We act as advisers first; we sit in such board meetings for free and alert the CEO to an warning signs we spot in these board meetings.”

Developing a *code of conduct* that establishes the ground rules of behavior, especially und conflicting circumstances, is helpful at this stage. More often than not, short-term challenges trounc the need for preparing such a code. However, when you do take the effort to prepare such a documen it establishes the ground rules and can be incredibly helpful, especially when conflicts arise.[1]

Value Creation, Accountability, and Transparency

One of the primary roles of a board is to ensure that the interests of all the shareholders are bein considered. In many startups, the primary shareholders and board members are often the sam consisting of the founders, CEO, and investors. As companies grow and develop, outside boar members, who aren’t involved in the business and don’t have a significant economic stake, get adde Collectively, this group is responsible for considering and balancing the interests of all th shareholders.

In addition to working to maximize the value of an economic outcome, the board also ensur accountability and transparency. In a formal sense, the CEO presents the ongoing progress of company and gives a periodic account of the business operations to the board. It is then the board responsibility to establish appropriate procedures, set milestones, and assess performanc Transparency ensures that all actions of the CEO and the board are conducted based on factu information with sound judgment and the interests of all shareholders in mind.

Functionally, the CEO works for the board. Graphicly CEO Micah Baldwin states, “As soon as yo raise money, it’s no longer your company—you are now working for somebody else. If you don perform, you will get fired. If I don’t get fired, then I know I’ve had a good board meeting. Th reminds me every month of my responsibilities.”

As a board member, a venture capitalist (VC) needs to act in the interest of the compan representing all shareholders, rather than their narrow interest as an investor. This is often a difficu conflict for an investor to manage, and you’ll often hear VCs qualifying their statements in a boa context using phrases such as “I’m wearing my investor hat now.” But as August Capital partner And Rappaport says, “I have a test I use. Can I explain my decision as reasonable and fair to ar shareholder group, not just my own?”

sample content of Startup Boards: Getting the Most Out of Your Board of Directors

- Knitted Amigurumi Edibles: Basic techniques plus 5 veggies for free
- A Good Killing (Anna Curtis, Book 4) here
- read online Wishful Drinking online
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