PART ONE

OVERVIEW

CHAPTER ONE

INTRODUCTION

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

While first-time chief executive officers (CEOs) and founders often have an elevated view of the boardroom, great startup boards aren't fancy, complex, or pretentious. Instead, a startup board is 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 some were terrible. When things in a company were going smoothly, the board was congratulatory and supportive. When there were challenges, some boards helped and some boards hurt. The tempo and interactions of these boards varied dramatically. In some cases reality prevailed, and in others it was denied.

In 2010, after a particularly tedious board meeting, Brad realized that the default structure of a startup board was an artifact of the past 40 years, dating back to the way early venture-backed company boards operated. Things had changed and evolved some, but the dramatic shift in communication patterns and technology over the past decade hadn't been incorporated into the way most boards worked. As a result, Brad ran a two-year experiment where he tried different things; some successful, some not. As with every experiment, he did more of what worked, modified and killed 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 the new startup board approach that resulted from Brad's experiment, it was important to lay the groundwork and explain clearly how startup boards worked, how they could be most effective, and what the challenges were. Brad's new board approach built on the traditional board of directors, so rather than throw it out, we use a highly functioning one as the basis for a new, evolved, and much more effective approach to a board of directors.

While the topic may feel dry, we've tried, as Brad and Jason Mendelson (Foundry Group, Managing Director) did in *Venture Deals: Be Smarter Than Your Lawyer and Venture Capitalist*, to take a serious topic, cover it rigorously, but do it in plain English with our own brand of humor. Our goal is to demystify how a board of directors works, discuss historical best and worst practices, and give you 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 new ground and explore uncharted territory while their unstoppable drive changes the world we live in. As a society, we should be grateful to the entrepreneurial force that creates new things, but often this new-new thing causes fear and uncertainty in the old and the established, followed by resistance and denial. Whether it is building a new product, landing the first customer, raising the initial round of capital, or recruiting early team members, an entrepreneur's journey can be lonely, stressful, and extremely challenging. While entrepreneurship currently is popular—even trendy—this is not always 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 bootstrapped, with the founders choosing to focus on generating revenue to fund their business, other entrepreneurs choose to raise money from friends and family, angel investors, or venture capitalists (VCs). The challenges of raising the first round of capital are well documented, and only a small percentage of 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 the desire for a substantial financial return, seek milestones, demonstrable progress, new rounds of financing at higher prices, or even quick exits. While some investors may be patient, taking a decade or longer view to helping build the company, others are more anxious to see quick progress. In many cases, these investors view the company as partly their own, which it in fact is, now that they've invested in it. Some of these investors are happy to support the entrepreneur in any way the entrepreneur needs them to. Other investors have their own view of what they, and the entrepreneur, should be doing—providing oversight, and "adding value" to the startup through their role on the board.

A long-standing cliché in the venture capital world is that VCs provide "adult supervision" to the entrepreneurs. We find this language to be pejorative and insulting to the entrepreneur and the company, so we try to avoid it. Instead of talking in abstractions, we'll describe clearly what VCs and board members can do to be helpful to the companies whose boards they serve on. We'll be equally 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 in conjunction with the first outside financing. Many early-stage companies never convene a board on a regular basis. In bootstrapped companies, the entrepreneurs have no outside investors so they often 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 of your company, regardless of how you are financed. If you do it correctly, choose the right directors, and engage them actively, they can help you dramatically accelerate your business. Then when you 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 University called "Startup Boards: Advanced Entrepreneurship." Clint says, "The most common mistake startups make is *not* having a board at all." He points out that research shows a majority of startups fail due to self-inflicted wounds—internal decisions about founding team, roles, equity, and other important issues. "Founders who are overconfident or choose to avoid conflict often miss an opportunity to bring in fresh perspective and structure these decisions from appropriate individuals," says Clint. "The other common mistake founders make is to populate the board with friends and family—you need to think carefully if they can address challenges or make decisions in the interest of the startup. Finally, often only founders populate the startups board—this often leads to confusion with respect to decision 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 are ecstatic that the long process of raising the venture round is almost over. During this process, many founders ignore the type of board members that come with the money. Smart founders understand that building a great company is all about the people and the members of the board are just as important as the early employees. “If I was prepping my younger brother on a startup journey, I would tell him to raise money only from those investors who can strategically add value and emotionally connect with 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 a result of control provisions in the financing document. They’ll also have a governance role as a result of their board seat. But more importantly they become part of the company as a result of their role on the board. While founders and investors often fret over control issues, Union Square Ventures partner Fred Wilson points out, “Boards should not be controlled by the founder, the CEO, or the largest shareholder. For a board to do its job, it must represent all stakeholders’ interests, not just one stakeholder’s interest.”[2]

The best entrepreneurs construct a board of directors the same way they build their core management team, recruiting the best people they can find for the roles that are needed. A great board member can be a superb coach and mentor—pushing you to grow, encouraging you to take on bigger challenges, and ultimately reaching your highest potential. Like any great coach, he will be careful 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 the entrepreneurs. Others can’t help but get involved in minutiae stir up conflict, and try to solve problems that they see emerging. This type of board member behavior gets in the way of the functioning of the company, confuses the management team, and, in the worst cases, damages the startup.

Constructing a good board starts with identifying investors and board members who understand the world of startups, know the dynamics of your market, and bring unique positive attributes that are often much more important than money. Founders, especially early in the life of a company, often feel like they have to make trade-offs to take money when it’s available, rather than patiently seeking the right investor for their startup. Being patient is worth it—ultimately having the right personalities will 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 intellect, experience, personalities, ego, emotions, and aspirations that, when combined correctly, can be a strong net positive experience for the company. It can be magical when a diverse set of experiences among board members—including product development, business strategy, financial expertise, general management skills, and broad network reach—are joined effectively. In contrast, when the ingredients don't mix well, it can be a disaster.

Your board is your inner sanctum and your strategic planning department.[3] The board guides, engages regularly, and builds a deep relationship with the CEO. But it is not simply a friendship—the board expects results and accountability. Value creation is a cliché in a startup's vocabulary, but if a CEO ignores the goal of building a valuable business, boards, especially those loaded with investors, 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 conflicts when they arise. We'll also help you understand how to get the most out of your board and how to address things when they aren't working. While a great board can be a guidepost and a positive catalyst, a bad board can cause angst and frustration, destroy value, and occasionally kill a company. 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 any entrepreneur, regardless of experience, location, or type of company. While we've written this book with the first-time entrepreneur in mind, we believe each book in the series applies to entrepreneurs with any level of experience. Having a "beginner's mind" often helps you learn new things. If you are 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 and worked with thousands of board members covering a wide range of experiences. While a few of these board members were spectacular and had a dramatic, positive impact on the trajectory and outcome of the company, many were average and had a neutral or insignificant impact. Others were detrimental. We've learned a lot from all of these experiences—both good and bad—and have tried to incorporate 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 board and interact with them on a regular basis. This can be extremely helpful or completely disruptive. The responsibility of a successful relationship between board members and members of the management team belongs to both the board members and the management team. As a result, we think every executive in a startup company can benefit from this book.

Throughout this book we've incorporated the advice of many investors, board members, entrepreneurs, and executives whose views we respect. We've used stories and examples that emphasize certain points. We give plenty of advice and provide tools for implementing this advice. However, we are still learning, so we'll continue to write about our experience, new experiments, and 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 certain words and phrases. This book was particularly tricky given the different roles participants play in a board, so we'll define a few right now. Our goal, as with everything we do, is inclusiveness, so you should err on the side of a broader definition when you encounter a magic word, unless we specify 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 it would be more effective to use one voice. We'll often refer to one of us in the third person; if you've read the book *Startup Life: Surviving and Thriving with an Entrepreneur* that Brad wrote with his wife, Amy Batchelor, you are already used to this approach.

Okay, let's get started.