BUILDING BETTER START-UP BOARDS

By Rob Barbara

BUILD VENTURES

I have been a VC for nine years. During that time, I made 11 investments and have sat on 10 boards as a director and another as an observer. Today I am a director of eight start-ups. There are many VCs with far more experience than me, but I have learned a few things and earned a few scars over the course of my career. More importantly, my eyes are now wide open to how critical boards are to the success of a start-up.

I have also seen that the impact of boards is asymmetric: boards are more likely to break a company than help it.

As a VC, I have experienced this first-hand. We have made mistakes. We rarely have enough true independence on the board and, worse, we have had board members with disproportionate influence on management, and even on other board members. We have moved on with an uneven number of board members and no chair, often creating ineffective meetings with an unworkable decision-making process. And we have generally moved on with too few experts that the company requires to make real progress.

Fortunately, we have learned from these mistakes. I will share some of those hard-earned lessons with you.

My goals from writing this are:

1. Provide a framework from which founders might build a better board including selecting board members at the Seed and Series A stages
2. Provide a framework from which founders might organize and execute better board meetings
3. Provide some thoughts on how VCs can avoid some of the problems that I and many others have endured.

Let's begin with an understanding of the role of the board. The board is an integral part of a start-up's management structure. It sets a significant amount of the start-up's strategy including fundraising, hiring and firing c-suite executives, setting budgets and determining an exit path.

But the board is not managing the company and needs to avoid the temptation to get too involved in the day-to-day operations. In fact, it needs to be disciplined enough to not succumb to the temptation of directly instructing the management team or, even worse, becoming a "backseat driver." There is an inherent inequality in the power dynamic that good boards understand and take care not to exploit. To do it right, the board needs to be properly constructed, filled with directors with the right skills and behaviors to make a positive contribution to the company.

BUILDING BETTER BOARDS

Ultimately, it is the founder's job to build the company board. And it's to their advantage. This might surprise some given that board composition is often a key element in most term sheets. But the founder is the person who negotiates the term sheets and ultimately decides which firms they take an investment from.

Most founders do not appreciate how important it is that they get it right - board membership is a key decision, something that can make the difference between failure and success. It's not just about smart money, it's about good people, good partners and good advice. So, founders need to think beyond the dollars and contemplate the role that any board member will play. Will they be a positive, productive and constructive board member?

Building a board needs to be as intentional as other critical parts of building a start-up. Founders should plan out how the board will evolve and, in doing so, identify the specific skill sets they need, chart what directors would best serve the company and at what phase in the company's growth cycle. By having a well thought out plan, the founder will be in a better position to recruit directors and negotiate term sheets.

Building a board needs to be as intentional as other critical parts of building a start-up.

Board Size

A board at the Seed Stage or Series A should have 3 or 5 members (not four).
These members are typically:

1. CEO
2. Seed Investor
3. Independent/domain expert Director (Chair)
4. Series A Investor
5. Another founder or another independent/domain expert

A seed stage company's board can operate well with just the first three. In fact, that is often a better option than filling two seats with less desirable directors. Founders can also add observers. Observers should be as fully engaged as directors and be willing to help inside and outside board meetings. Yet because they do not have a vote, founders have more flexibility on who they add because it will not affect the balance of power on the board.

I urge founders to get at least one independent director. Independent directors are important as they are the bridge between management and investors whose interest can diverge from time to time. In fact, having an independent director serve as chair can be advantageous for start-ups when that option is available.

What is independent? The securities commissions tend to believe an independent member is one who has no financial interest in the company. I think this is too extreme. It is important to have board members who have “skin in the game.” Independence is determined by whether there is anything that could affect the board members ability to always act in the best interest of the company, in other words to avoid any conflicts. Of course, directors are legally bound to act with a Duty of Care and a Duty of Loyalty, but management and investors do have other motivations, even if they are subordinate to their director duties.

Independent directors should not have any other motivations other than protecting their reputations which I believe they will do if they always act in the best interest of the company. An independent director must be carefully recruited rather than picked from either the founders or the investors networks. If chosen from within one of those networks, is the director truly independent? (And have you also added to thought diversity? More on that later…)

To help attract the right kind of quality independent directors, founders should be willing to give the independent board members a sizable option grant. The amount granted would depend on the stage of the company, the quality of director and whether they serve as chair.

What To Look For In A Director

You want directors who are smart, experts in an area that helps the company, keen to help, engaged and ready to offer an opinion but do not think they can run the company better than management. You also want to match directors with what the company needs at that time. Every director should be judged on whether they are the right person at the right time. They also need to work productively and collaboratively with the management team. Are they able to hold the management team accountable and challenge them in a way that ensures maximum performance? You do not want directors who bring out the worst in management or are simply “yes people” that inevitably pave the way to mediocrity. You want directors who motivate management to always bring their “A” game. Other factors to consider include:

- The needs of the company are always evolving with its stage and so the directors may need to be changed from time to time.
- You want directors who have “been there/done that” and will advise on a hands-on basis.
- You want directors with sharp opinions who are willing to share them in a productive manner.
- Directors need to be responsive at the same pace of a start-up.
- Directors who have the best interest of the company at heart and add real value inside and outside of meetings.
- You also want to find directors that fill key gaps in the management team, including the founder. This is an additional opportunity to get the skills and knowledge necessary for success.

Finding great board members who work productively to help the company both during and beyond the board meetings can be a tremendous help to founders. But as noted earlier, boards tend to do more harm than good and that is often because the wrong board members are recruited.

Avoiding picking the wrong board members is therefore vital to long-term success. Here are some types of board members to avoid:

- A board member who takes credit for the success of the company. Many VCs feel that they need to add value but it goes too far if they think they are the difference maker.
- Board members who truly think that they know better because of their unique experience. Board members never understand the nuances that management understands nor do they truly understand the unique circumstances the company faces – these are likely much different than those they have faced in their own careers.
- Beware of the person who might be too much of a domain expert because of their narrow focus. It might be the case that they are too entrenched to be disruptive to their industry.
- Beware of the person who has spent their whole career in a large company.

> Every director should be judged on whether they are the right person at the right time.

Picking the right people to sit on your board takes a lot of work and forward planning. The process should be formal, and many founders employ recruiters to expand their networks. Diversity is important to effective boards. Reaching beyond your personal network and your investors' networks helps avoid a lack of diversity that could risk one-dimensional thinking. Find people with different backgrounds and perspectives. Again, one might also question whether people inside these existing networks are truly independent.

The role of chair is a critical consideration when formulating a board. The chair sets the agenda with the founder and helps ensure the board sticks to it during any meeting. A good chair gets members to engage in productive, balanced and fair discussions. What's more, the chair moderates meetings, ensures the discussion stays focused and manages those who need it.

BETTER BOARD MEETINGS

Now that you have built your board, how are you going to get maximum value out of it?

While that value can be experienced both during and after the board meetings, let's focus here on board meetings. There is no question that if board members are not contributing in a meaningful way away by providing ongoing advice or by using their networks to help with business development, partnerships and financing, you are not getting maximum value from them. It is the founder's responsibility to hold them accountable.

Founders need to view board meetings as an opportunity to get real work done, supported by people with the skills and experience that may be missing from the management team. Founders should bring real issues to the board. Many founders struggle with this and instead think they must always put positive spin on issues. They think they are still selling to the investors who might be critical in securing future rounds of financing. That's not correct – founders should count on the board to help them overcome the obstacles they will surely face.

A productive board meeting goes well beyond simply reporting and oversight. The meeting should be primarily about helping founders be successful. Founders should not create an agenda focused solely on reporting, instead taking advantage of the talent and insights around the board table to tackle strategic challenges, planning for the future and solving problems.

I believe strongly that the board meeting agenda is the tool that helps with this common problem. The chair needs to ensure that the agenda items and the time allocated to them are focused on building for the future rather than looking to the past. I propose the following board meeting structure which we have used with some of our portfolio companies with great success (some elements taken from Sequoia Capital):

1. Open the formal board meeting with the CEO reviewing the Big Picture - highlights, challenges and needs. This should take no more than 5 minutes.
2. Move onto the reporting section where, preferably, various senior team members present the metrics for their functional area - funnel, engagement and financial. At this time, you can deal with key issues as they arise unless they require a significant amount of discussion. If they do, then it should be one of the topics for the working session to be held later. Reporting should take about 30-40 minutes.
3. Complete all board meeting business by passing any motions and agreeing to the time of the next board meeting. Once completed, adjourn the meeting and stop taking minutes. The whole board meeting should take an hour at most but preferably less.
4. Working session: this is the meat of the meeting. This is where a CEO can derive real value from their board members by bringing one or two key issues forward for a focused deep dive with appropriate time allocated to it. Up to 90 minutes can be assigned to the working session.
5. Finish with an In Camera session.

The founders in my portfolio who use this method believe that the reporting is more succinct and focused on key metrics. They also derive better advice during the working sessions. The simple act of ceasing to take minutes allows them to be freer with the working session. Furthermore, they can invite targeted guests to the working session who otherwise would not be included in a board meeting, increasing the meeting's value.

Preparing For The Meeting

Many founders distribute a deck a day or two in advance, hoping that board members will review it. It is assumed that the deck will be reviewed during the meeting so it turns out that few board members review it in advance beyond a quick skim. This approach reduces the effectiveness of the meeting and the value participants get from it.

Instead, founders should be in constant communication with board members on a one-on-one basis. It shouldn't be every week, but it also shouldn't be more than a month between contact. Those discussions should help the founder prepare each director for the meeting. All the issues should be discussed, and the founder should have feedback from every member allowing the founder to iterate on what they will present for discussion and decision. The goal is to consolidate the views at the board meeting and to efficiently move on to consensus. This is more likely to happen if much has been discussed before the meeting.

The agenda should be set early, and the materials should be distributed a week in advance. Once distributed, the founder should have a final call with each director to get any additional feedback and to answer any specific questions they have. It should be understood that the full deck will not be presented at the meeting, only highlights and key metrics. No new topic should be introduced after this point unless something very urgent comes up. To do so will be viewed unfavorably by directors who may view it as the founders attempt to railroad a decision.

> Founders should not create an agenda focused solely on reporting, instead taking advantage of the talent and insights around the board table to tackle strategic challenges, planning for the future and solving problems.

THOUGHTS FOR VCS

As noted earlier, it is the founders who build the board. They decide who to take investment from and who gets a seat on the board. It is their thoughtfulness, planning and hard work that recruits great independent board members. As a VC, if you back good founders who understand this, that is the first step to avoiding the pitfalls many have experienced resulting from weak or ineffective boards.

VCs simply need to spend more time talking about a founder's plan for the board to get comfortable that they are approaching it in the right way, and they have the character traits and skills required to deal with the issues that will arise. It is in everyone's interest – founders, management team and investors alike – to have a well-functioning board to help guide the start-up on its journey.

VCs should spend the time asking the founder questions about what they want from a board and how they think it will help them build the company. Ask them what kind of directors they would like to have on the company. See how intentional they are in describing the people, skills and support they think they need to be successful.

Selecting the right board members is a critical step on the journey to start-up success. Using that board in the right ways is also key - this can be tricky. While board members almost always bring deep expertise to their role, that can often stray over to directing the management team on how to execute on their vision. That's not the board member's job – rather, they should focus on providing the strategic advice needed to help the founders and management team succeed.

At the same time, you do not want a board that is passive, simply rubber stamping the founder's reports and proposals. A good board member challenges the founders – constructively and respectfully but determinedly. Everyone shares the same goal: helping the company succeed. Board members must provide good advice and open doors to new relationships. Reviewing the reporting on metrics is an important part of that process but the greater value comes from helping the start-up strategically chart its path toward the future.

That also underscores the importance of the independent director, particularly, in the right circumstances, one that serves as chair. That independence can give them an unbiased view of any given situation. Equally important is having diversity on a board rather than simply selecting a handful of acquaintances from relatively narrow personal networks – diversity in experience, background and opinion can be a key competitive advantage.

A highly functioning board of directors is vital to a start-up's success. Choosing the right composition is both art and science. Smart founders and VCs put real effort into this process, recognizing its importance. A good board that is firing on all cylinders helps with ongoing governance, but the biggest benefit comes when all that expertise and experience melds with the founder's passion and gels into a meaningful strategy.

That's where the magic happens.

The author would like to thank John Phillips, a longtime friend and experienced board member, for his contribution to this article.