



ANGEL CAPITAL ASSOCIATION

# Early Stage Boards and Governance

September 18, 2019

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- Use chat to submit questions
- Yes, you'll get the slides and video
- We're recording, so come back and listen again
- Contact Heather Krejci with questions:  
[hkrejci@angelcapitalassociation.org](mailto:hkrejci@angelcapitalassociation.org)

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# ANGEL CAPITAL ASSOCIATION TODAY

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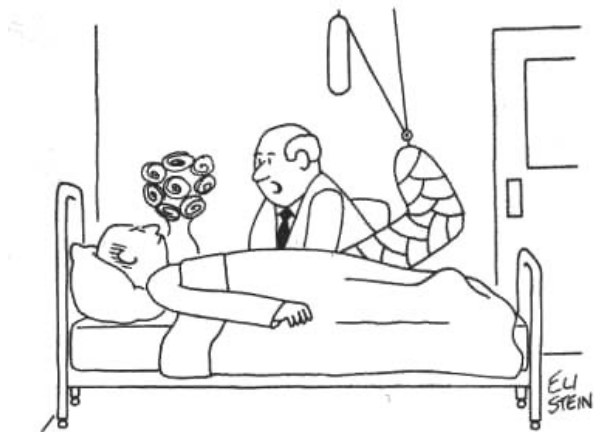
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## OUR SPEAKER: RON WEISSMAN

- Board Member, Angel Capital Association
- Band of Angels, Berkeley Angel Network
- VC at Apax Partners (17 years)
- 40+ boards as Chairman, Director or Observer here and abroad
- Senior executive at NeXT (reporting to Steve Jobs)
- CMO, Turnaround of the Year (Verity)
- Mentored and/or invested in 60 companies
- Angel outreach: Australia, New Zealand, Hong Kong, Italy, Chile, Germany, Armenia, Republic of Georgia, US White House
- Author of multiple works on the Italian Renaissance



# EARLY STAGE BOARDS AND GOVERNANCE



Ronald Weissman

September 18, 2019

*“And the Board of Directors voted to wish you a speedy recovery, 3 to 4 with 2 abstentions.”*

# GOALS

- Understand startup company Board basics
- Understand Director's legal duties and obligations
- Maximize Director effectiveness
- The CEO's role, challenges and relationship with the Board
- Stay out of trouble!
- All in the context of life after Series Seed and Series A

# WHAT YOU'LL LEARN ABOUT TODAY

- Zombies!
- Why good Board meetings are like nuclear arms treaties
- NIFO!
- The problem with Board observers
- The RED Zone

# AGENDA

- Introduction: Board Basics
- Building a Board
- Governance
- Best Practices in Working With Your Board



# AGENDA

- Introduction: Board Basics
  - Role and Duties of the Board
  - Changing Board Role as Company Matures
- Building a Board
- Governance
- Best Practices in Working With Your Board

# DEFINITION

## ***Board of Directors:***

a group of persons elected by the shareholders to jointly govern the affairs of a corporation.



“By demanding to nominate directors you shareholders act as if you own the place.”

you own the place.

# HOW ARE BOARDS ESTABLISHED?

- C Corporations\* are required to have a Board
  - Specific rules differ by state
- Formed via Company Charter / Articles of Incorporation filed with state
  - Company name, stock, officers, directors, by-laws
- Changes to Articles of Incorporation: usually occur as a result of new financing rounds
- Financing rounds are the easiest time to mandate better governance
- Best practice: Directors should familiarize themselves with Articles (including by-laws), Investor Rights Agreement, last round's final term sheet, company's current cap table

\* C Corporation: Any corporation that is taxed separately from its owners.

# DUTIES OF THE BOARD\*

1. Determine the Company's Mission, Purpose & Risks
2. Hire & Fire the CEO
3. Support the CEO, Review His or Her Performance
4. Ensure Effective Organizational Planning
5. Ensure Adequate Resources

\* From BoardSource – with additions



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# ROLE OF THE BOARD CHANGES OVER TIME

(Next three slides)

- Ensure High Integrity Corporate Governance
- Hire/Review CEO, Approve Exec Hires
- Approve Strategic Plans
- Monitor Performance Against Plan
- Ensure Audit / Hire Audit Firm
- Hire Law Firm
- Exec Compensation & Stock Option Grants
- Ensure Shareholder Communications

| Early | Expansion | Exit |
|-------|-----------|------|
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# ROLE OF THE BOARD CHANGES OVER TIME

All of the above plus...

- Hire Investment Bank
- Approve M&A
- Prepare/Execute IPO
- Ensure Wind down / Liquidation / ABC Process

Early

Expansion

Exit

# TAKING VENTURE CAPITAL CHANGES BOARD DYNAMICS

|                     | Angel/Series Seed                          | Venture Series A, B, C, ...                      |
|---------------------|--|--|
| What's Important    | The story and the vision                   | Metrics and milestones                           |
| Balance of Power    | CEO is still co-equal                      | Power shifts to investors                        |
| Board               | 3 to 5 person                              | 5 to 7 person                                    |
| Meeting Focus       | Ideas, Product, Engineering, Hiring        | Drill Down Reporting                             |
| Company Goal        | Raising Next Round                         | Raising Next Round                               |
| Next Round Requires | Product Validation,<br>Early Customer Wins | Business Model Validation & Sales<br>Scalability |
| CEO & Board         | <b>Honeymoon</b>                           | <b>Danger Zone!</b>                              |



# REMINDER: MOST IMPORTANT TASKS FOR AN ANGEL DIRECTOR

- Never run out of cash
- Hire/Fire the CEO
- Sell the company

Source: John Huston



# AGENDA

Introduction: Board Basics

## Building a Board

- Building and Running a Board
- Composition
- Effective Meetings
- Board Committees

Governance

Best Practices in Working With Your Board



# EARLY STAGE BOARDS

- Boards defined in current financing round term sheet & closing docs
- Board service is a risk and major obligation, not an honor!
- Early stage Boards can consume hundreds of hours a year
- Don't confuse a fiduciary Board of Directors with advisory boards

# BOARD COMPOSITION

Composition defined by Company Charter, modified by future financings

Series Seed Boards

- THREE: 1 founder, 1 preferred shareholder, 1 independent (1:1:1), or
- FIVE: 2:2:1 or 2:1:2

Series A (and probably B)

- THREE: 1:1:1, or
- FIVE: 2:2:1 or 2:1:2

Series C and beyond

SEVEN: 2:3:2

- Strategic investors may serve as observers

# ELECTION & BOARD SERVICE

- Board Elected annually by shareholders, generally eligible for re-election
- Investor Series Directors: Nominated by Preferred Investors
- Independent Directors: Nominated by Common and Preferred
- Always have a mechanism for removing Directors

# THE ROLE OF THE BOARD CHAIR

- Schedule meetings
- Manage agenda, keep meeting on track
- Oversight of committee work process
- Resolve conflicts
- Mentor an inexperienced CEO
- Best practice: Chair should be independent of management and not CEO
- No cronyism

# ROLE OF THE INDEPENDENT DIRECTOR

- Provides Board with deep expertise
- Serves on Independent Director Committee and ensures good governance by providing a disinterested view and “fairness opinion”

# SELECTING INDEPENDENT BOARD MEMBERS

- Not aligned with any class of shareholders
- Varieties of expertise:
  - Governance (resolve disputes, understand Board best practices)
  - Financial operations (experience as CFO)
  - Compliance (especially biopharma or financial services)
  - Exits (managing M&A or IPO process plus good network)
- Continued service depends on continued relevance
- Has the time to serve; not on very many Boards



# ROLE OF BOARD OBSERVERS

- A non-voting right granted to minority or strategic investors
- Monitors company progress, should listen more than speak
- Has restricted information rights (limited visibility into sales pipeline and business development to avoid conflicts of interest)
- Does not attend “closed door” executive sessions
- NOTE: If too involved, can be subject to the same liability as Directors but without indemnification or D&O insurance

# AN EFFECTIVE DIRECTOR

- Understands governance & fiduciary role
- NIFO: Nose In, Fingers Out
- Utilizes specific market or domain experience
  - Understands sector business, metrics and competitive landscape
- Discloses conflicts of interest before joining and as issues arise
- May fill special Board needs or gaps or take a temporary operating role
- Serves as an effective ambassador
- Uses business network to grow the company

# ADD VALUE IF YOU WANT TO KEEP YOUR ANGEL BOARD SEAT

- Board seat is critical to protecting Angel rights
- Board seat is critical to understanding the company's true status
- Your Board seat is vulnerable to Board restructuring at next round UNLESS:
  - You helped recruit the follow-on VC investors
  - You are viewed as a necessary and effective CEO mentor
  - Your industry knowledge and network provide the company with an unfair advantage
  - You are viewed as an experienced Director with significant value-add
  - You (or your angel group) has strong brand, investing, syndication and networking relationships across your entrepreneurial ecosystem

# BOARD COMPENSATION

- Early Stage Boards (no cash, if possible)
  - Angels: 0.25% to 0.5% equity for Board service
  - VCs: no compensation
  - Independents and Directors appointed by VCs: 0.25% to 0.5% equity
  - Non-Executive Chair: 0.5% to 1% equity
- Later Stage
  - Equity plus cash compensation (fees per month or per board meeting)

# STRUCTURE OF A BOARD MEETING

- Meeting run by Chairman or CEO
- CEO's report
  - Key operational results, key issues
- CFO: current financials, results vs. annual plan
- Departmental updates
- Strategic issues
- Closed session (Directors only)
  - Approval of minutes, resolutions, stock option grants
- **Executive session** (outside Directors only--no management)
  - Governance issues
  - Feedback for CEO

# BOARD PACKAGE (SENT BEFORE MEETING)

- CEO's Report
- Standard Financials: Balance Sheet, P&L, Cash Flow
- Operational Dashboard
  - Actuals Against Plan, QTD, YTD, Current Year vs. Last Year
  - Key metrics from business model
- Operational Updates (Sales, Marketing, Product Development, Regulatory Affairs, Support)
- Compliance Issues
- Subcommittee Reports
- Resolutions
- Approval of Prior Board Minutes
- Approval of Option Grants

# CEO'S REPORT

- Important news
- High-level summary of recent performance against plan, including metrics and milestones for sales, product development, business development, fundraising and other key functions
- New strategic initiatives
- Update on management hiring
- Update on fundraising
- Update on business environment & competition
- Current company goals and areas of focus
- Experienced Directors should work with new CEO to define what will be in standard report

# A GOOD BOARD MEETING

- Accurate view of performance, trends, threats and opportunities affecting long-term shareholder value
- Identifies gaps between actual performance and plan & remediation plans
- Balances view through rear view mirror and windshield
- Deep dive into one substantive issue per meeting:
  - Annual business plan, product development, sales performance, marketing, customer support, regulatory compliance, exit planning
- Has **NO** surprises



# SO, WHAT DOES THIS MEAN IN PRACTICE?

- Review financials—especially cash—to ensure runway and the integrity of operations
- Monitor current performance against current plan
- Advise on strategy & execution and assist in resolving key issues
- Approve significant transactions constraining company in the future
  - Financing, leases, OEM deals, major contracts, stock options, M&A, litigation
- Disclose conflicts of interest
- Be open to the high-level concerns of any stakeholder
- Question thoughtfully: like arms treaties, **Trust but Verify**
- *What not to do*: micro-manage operations

# BOARD COMMITTEES

- All companies
  - Audit and Compensation committees
- Maturing companies
  - Nominating and Executive committees
- As needed
  - Exit and Investment committees
  - Independent Directors' committee

Fun Fact: After the 2000 meltdown, it was discovered that public company compensation committees met 8X more frequently than audit committees!

# AGENDA

- Introduction: Board Basics
- Building a Board
- **Governance**
  - Legal Obligations of Directors
  - Trouble Zones
  - M&A Issues
- Best Practices in Working With Your Board

# DIRECTOR'S LEGAL OBLIGATIONS: BASIC CONCEPTS

- A **fiduciary** is someone entrusted to manage the assets of others, acting wholly on behalf of those persons without respect to the fiduciary's personal interests. A **fiduciary** fulfills this duty with the highest standard of care.
- **Duty of Loyalty** -- make decisions without regard to interests not broadly shared.
- **Bona Fide** -- Act in good faith in interests of company rather than self interest and without violating the law.
- **Duty of Care** -- make informed decisions (documented in Board minutes).

# DIRECTOR'S LEGAL OBLIGATIONS

- **Business Judgement Rule** – Board actions are protected if Directors seriously believe actions are in the best interest of the corporation as a whole (Board minutes are critical)
  - Standard of judgement: “What would a reasonable person do?”
  - Protection depends on evidence of Duty of Care and Duty of Loyalty
- **Entire Fairness** – transactions involving ‘interested parties’ are reviewed in context
- In liquidation, Directors’ duties expand to include creditors



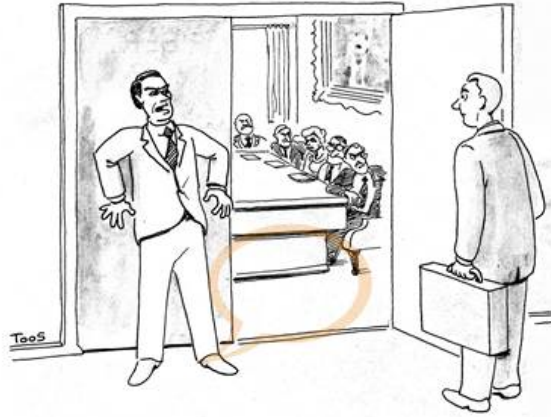
# DIRECTOR'S LEGAL OBLIGATIONS DURING M&A

- **Revlon Rules** – In M&A, **Directors'** must maximize short-term shareholder **value** rather than long-term corporate interests and can serve as “auctioneers”
  - **Fiduciary Out:** Directors cannot waive fiduciary duties to shareholders
  - Best practice: Add ‘fiduciary out’ clause to M&A term sheet
- Smart practice: Have your law firm explain in person the “Duties of Directors” memo to all Directors and Officers at start of M&A

# DIFFERENT ROLES OF DIRECTORS AND INVESTORS

- **Directors:** fiduciary governance and oversight of the company on behalf of all shareholders
- **Investors:** rights enumerated in the Investors' Rights Agreement
  - Vote by class (Series A, Series B, etc.) on specified issues
  - Appointing Class or certain other Directors
  - Approve any changes to capital structure or investor rights or economics
  - Rights of first refusal, anti-dilution, co-investment...
  - Approve the sale of the company

# DIRECTORS INEVITABLY FACE CONFLICTS OF INTEREST



"You go first, I'll cover you."

- Fiduciary duty to the company and all shareholders vs. duty to self, fund or investor class. Increasingly, this obligation can extend to all stakeholders
- Solutions
  - Full Disclosure
  - Affected Director Recusal
  - Use of Independent Director voting and written opinions



# DIRECTORS' LIABILITY

- Business Judgment Rule (Delaware) applies to many situations if you demonstrate Duty of Loyalty & Duty of Care, BUT:
- **Red Zone** / Zone of Insolvency: Directors are personally liable for:
  - Accrued employee wages & vacation pay
  - Federal and state payroll & income taxes
  - 2X penalty for willful failure to pay wages
- Insolvency risk doesn't override Directors' obligation to maximize shareholder value
- Delaware generally protects Directors acting in good faith from insolvency creditor law suits
- VCs who have VC supplied D&O coverage may be willing to operate in the Red Zone, leaving non-VC Directors exposed to greater risk
- States have different determinations of Director's personal liability for unpaid wages and state taxes
- Protections??
  - D&O Insurance
    - May not cover Red Zone liabilities
  - Charter indemnifications & indemnification agreements
  - Ugly reality – **you may be unprotected**
  - **Best defense:** get your corporate law firm with a strong venture-stage practice involved well before you hit the Red Zone

# BOARD TROUBLE ZONES

- Balancing adding value and maintaining objectivity
- Not usurping Corporate transactions personally
- Personal Relations with Employees/Executives
- Related Party Transactions
- Financing & M&A:
  - Insider Dealing
  - Independent Directors Committee
- Dissolution/Wind Down:
  - Duties shift to Creditors... and to the state
  - Long-tail liability
  - ABC (Assignment for Benefit of Creditors)
  - VCs and Angels may have different risk profiles



# DYSFUNCTIONAL BOARDS

- Lack of alignment between Board and Management
  - First time Directors and/or first time CEOs
  - Liquidation preference distortions-- can be fixed with carve out
- Zombie investors
- A management crisis may force Board to manage the company directly, a last resort, not a standard practice
- Lack of alignment among investors--different economic incentives
- Lack of alignment between common and preferred shareholders
- Over-alignment between independent Director and investors or management



# CEO CONFLICTS OF INTEREST

- CEOs are human; have more at stake emotionally and financially than investors— (and are essential to businesses success and exits.)
- Fear of firing: hide or spin bad news
- Undermining executive hires “recommended” by the Board
- Highly dilutive option increases in the absence of commensurate business valuation increased
- Lifestyle CEOs



# CEO CONFLICTS OF INTEREST - continued

- M&A
  - Siding with buyers against investors
  - Sweetheart deals for execs joining buyer's company
  - Maximize management returns at expense of shareholders—"directed carve-outs"
  - Undermining Board-approved exits
  - Not disclosing M&A interest
- Good Boards will ensure that the CEO's interests are safeguarded so that everyone is playing on the same team.

# M&A RESPONSIBILITIES OF DIRECTORS

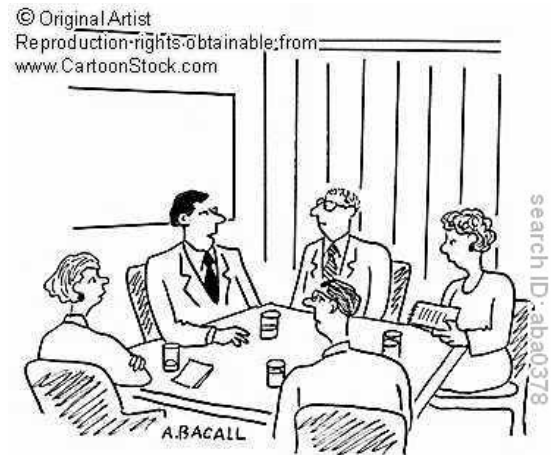
- Typically, 5- 7 years to M&A
- Role of Directors
  - Maximize outcome (Revlon rules) for all shareholders
  - Direct the process: negotiating authority rests with Board, not Management
  - Select an i-banker, law firm
  - Approve the Term Sheet and Definitive Agreement
  - Shareholders vote on the final transaction
- May need fairness opinion (from independent Directors)

# AGENDA

- Introduction
- Building and Running a Board
- Governance
- **Best Practices in Working with your Board**

# DIRECTOR BEST PRACTICES

1. Review Board package before meeting
2. Don't be a 'drive by' Board member
3. Attend in person
4. Always have an executive session



"Last week many of us had a tight schedule so our meeting was rushed and very short. Miss Jones, please read the seconds of our last meeting."



# WHAT THE CEO WANTS FROM ITS DIRECTORS

- Engaged and available – takes “midnight phone call”
- Open communications and honest feedback
- Creative experiential problem solver; focuses on solutions
- Opens personal network for strategic partnerships and hires
- Peer comparisons “how do other companies deal with this?”
- A good mentor.... but doesn’t micromanage
- A team player, not a “master of the universe”
- A proactive ambassador for the company
- Acts with integrity and honesty, serves the interests of all shareholders

# WHAT DIRECTORS WANT FROM THE CEO

- Views Board engagement as opportunity not nuisance
- Use the Board as a strategic sounding board
- No surprises
- Timely & full disclosure and root cause analysis, not positioning
- Keep a rolling one-year Board calendar
- D&O insurance and Indemnification agreement
- Timely distribution of information and Board materials
- Work to resolve management conflicts of interest

# BOTTOM LINE FOR ANGEL DIRECTORS

- Board service is not a merit badge with bragging rights
- Proper governance and Director engagement build resilient companies
- Help the CEO grow as the company grows
- Faithfully execute fiduciary duties
- Address conflicts and trouble early
- If you want to keep your group's Board seat, focus on adding value
- Be a great ambassador and use your network and experience to grow the company



# QUESTIONS (AND THANKING OUR PARTNERS)



ACA Data Partner



ACA Education Partner



Small Business Innovation Research (SBIR)  
Small Business Technology Transfer (STTR)

Platinum Partner

Gold Partners



Feed the Future  
Rwanda Nguriza  
Nshore Project

Silver Partners



Bronze Partners



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# IN-PERSON STARTUP BOARDS WORKSHOP

**October 16** – Register now to attend the launch of the in-person Startup Boards Workshop. This half-day workshop with Ron Weissman and Bill Payne will be presented in conjunction with the Leadership Workshop in Cincinnati. Learn more -

<https://events.angelcapitalassociation.org/19lw>

**Bring this workshop to your community!**

ACA members interested in bringing this workshop to their hometown should reach out to Heather Krejci –  
[hkrejci@angelcapitalassociation.org](mailto:hkrejci@angelcapitalassociation.org)



# UPCOMING WEBINARS AND DEMOS

**October 9** – Pre-Money Valuations: Do They Matter as Much as Many Angels Think?

[www.angelcapitalassociation.org/webinars/](http://www.angelcapitalassociation.org/webinars/)



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ANGEL CAPITAL ASSOCIATION

# UPCOMING ACA GOLD STANDARD EVENTS & EDUCATION

- October 15-16, 2019, ACA Leadership Workshop (*Cincinnati, OH*)
- October 16-17, 2019, ACA Midwest Regional Meeting (*Cincinnati, OH*)
- November 6, 2019, ACA New England Regional Meeting (*Boston, MA*)
- May 12-14, 2020, ACA Summit (*Westminster, CO*)

