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The Importance of a Startup's Board of Directors

By Steven Howard Roth

Countless new businesses, commonly known as "startups," are launched each and every day, and while some of them may have better business models than others, a startup's ability to successfully grow from a seed into a stable, mature, and profitable business often depends on much less perceptible decisions. In particular, one of the most overlooked, yet incredibly important challenges every startup faces, is the selection of its board of directors.

The board of directors of a startup sets the tone for everything that happens in the company from the very beginning of its existence. The directors appoint the corporation's officers that run the day-to-day business, make decisions regarding the issuance of stock in the corporation, and determine the general direction of the corporation, including, but not limited to, providing guidance to shareholders on whether the corporation should merge with or acquire competitors or other businesses. Even though a corporation's officers are in the trenches each day running the general operations, the directors have a bird's eye view of the startup as a whole, and can help steer the ship to where it needs to go as situations develop and opportunities for growth arise. In short, the board of directors, if working correctly, helps maximize the value of the startup for shareholders.

Despite the vital role the board of directors play in the operations, growth, success, and stability of a corporation, many startups fail to take the time to carefully and thoughtfully form their company's board, and, as a result, either directly harm the organization's prospects of success, or, at a minimum, significantly hamper the corporation's growth or rate of growth. Although the factors that a startup should consider when forming its board varies from company to company, the following are some general guidelines the vast majority of startups should follow to ensure that the company is put in the best possible position to grow from the outset:

> **(1) Size of Board:** While it may not seem like a big deal to have an even number of board members, it can cause major headaches, which are otherwise preventable. If the board has an even number of directors, and the directors are split evenly when voting on a matter that requires majority approval, a deadlock can occur. Yes, there are mechanisms that can be put in place to deal with deadlocks, but it's best to avoid having to deal with that situation, if at all possible. The easiest way to address this issue is to make the number of directors on the board an odd number. In the beginning, most startups should have a minimum of five board members, especially if the company is soliciting investments.
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> **(2) Diversity:** Startups should be methodical in selecting their board of directors. As with everything in life, diversity should be valued. The more diversity, the better. Often startups stack their boards with individuals that have the same or similar background, education, life experiences, ethnicity, etc. The result? Often, it will lead to everyone agreeing on everything and preventing the type of real dialogue and critical thinking among the directors that is necessary to curb impulsive action and allow a company to successfully handle the various road blocks it will encounter as it develops. Although a startup does not want its board of directors to debate every single decision to the extent it kills momentum, growth, or decision making, consistent, substantive discussion of material issues is extraordinarily important. Diversity among the board

also enables a startup to gain insight into numerous segments of the population and help fuel additional interest in the company's success.

(3) Expertise: Initially, the board of directors of many startups is often comprised solely of the founders. If the startup accepts investments from third-parties, the odds that the board of directors will incorporate individuals other than the founders increase significantly. Regardless of the stage of a startup, however, the board of directors does not need to, and ideally should not, solely consist of the founders. Instead, startups should strive to identify and appoint individuals to their board that bring expertise in areas that are not only related to the core services or goods being produced, sold, or offered, but that also provide expertise with operational and other matters that all startups, regardless of the industry in which they belong, will face. For example, a startup that operates in the food services industry would be wise to have individuals on its board of directors with significant experience working in that industry (or a related one), such as the CEO and/or owner of a successful local restaurant or restaurant chain, an attorney well versed in transactional matters and regulations within the food industry, and an accountant that routinely handles sophisticated tax returns and accounting matters for startups. Without a doubt, appointing friends and family to the board of directors, simply because a founder "owes" them, or they have invested money in the startup, is a very bad idea. Unless those individuals are able to truly bring experience, expertise, connections, or unique and valuable insight to the table, they have no business being on the board. One of the main keys to crafting an effective and well-rounded board of directors is trying, to the extent possible, to make sure each director adds something unique and useful to the group. The more well-rounded, diverse, practical, and experienced a board of directors, the better the startup will be able to handle the growing pains and speedbumps that will inevitably occur as the company matures.

If you have any questions about this topic, please contact one of the listed Roetzel attorneys.

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