Michael Hilb
(Editor)

Governance of Ventures

The Role of Venture Boards, Entrepreneurs and Investors in Entrepreneurial Value Creation

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Corporate Governance in International High-Tech Startups

Prof. Dr. Rico J. Baldegger

Abstract

While the benefits of a board of directors are well understood for more established firms, the role of the board for new ventures constitutes a particular challenge. A new venture's board of directors is highly consequential for its most important strategic and personnel outcomes. Based on the observation of multiple board meetings and several interviews with board members, this article reflects on how organization and strategy influence new venture boards. It summarizes key findings and identifies the most important limitations. It also explains how new international venture boards are impacted by venture capitalists and lays out their distinctive nature. New insights on venture board composition, structure, process, and transition to public firm boards will be relevant to venture executives, investors, and directors.

Author

Rico J. Baldegger is Director and Professor of Strategy, Innovation and Entrepreneurship at the School of Management Fribourg, Switzerland, University of Applied Sciences and Arts Western Switzerland, HES-SO. He has studied at the Universities of St. Gallen and Fribourg. His research activities concentrate on innovative startups, the entrepreneurial behavior of individu-als and organizations, as well as the phenomenon of rapid-growth companies. He has published several books and articles and, since the beginning of the 1990s, has been the CEO and founder of a business for company development. Moreover, he is a business angel and a serial entrepreneur, as is demonstrated by the many companies he has created.

1 Venture Board Structure

The dynamic situation of international technology ventures increases the complexity for the board, especially in relation to venture capital questions and the company's long-term positioning. As part of legal and fiduciary responsibilities – which include setting policy with shareholders' best interest – corporate boards are increasingly tasked with dealing with volatile and uncertain market developments – be it from worldwide economic turbulence, cyber attacks, asset bubbles in a major economy, or data fraud or theft (Aengus 2019). Directors are not fully confident that they can always tackle the challenges, manage risks and focus on long-term strategic goals. Thus, top management is confronted with dilemmas like resource provisioning versus monitoring, expenses/income versus future strategic potential, early versus (too) late involvement in decision-making processes, stable versus dynamic, efficiency versus effectiveness or exploration versus exploitation.

Given that there are different types of venture directors, it is important to consider them distinct actors and, simultaneously, to examine their effects on strategic outcomes. In general, venture directors are often very well informed about the venture's sector and have strong financial incentives related to the success of the firm. On one hand, we have inside directors, like the CEO and possibly other executives.

We also have outside directors, like venture capitalists or business angels, corporate venture capitalists, founders who are no longer executives, or independent directors (consultants, market experts, lawyers, entrepreneurs, academics).

Investor-directors usually own or represent "exceptional shares", with better terms and payoff than the "common shares" owned by others (Fried & Ganor, 2006). These strong incentives can motivate investor-directors to be inclined to pursue their own self-interest – which can have both positive and negative effects on the international venture. Venture Capital directors could have a positive effect on commercial innovation (i.e. product commercialization) and yet a negative effect on technical innovation (measured by number of patents). Notably, corporate venture capital directors have the opposite effects on these two types of innovation. Furthermore, independent directors are likely to support venture capital directors in offsetting the positive effects of CVC directors on technical innovation. Accordingly, venture boards may need to evolve to compositions that are more diverse in order to realize different types of innovation over time.

Venture boards usually have a very simple formal structure and often have no committees or even overall board chairs. As a result, board activity involves the entire board as an entity and the CEO as a central actor. Finally, the venture board size is typically small, although it can increase over funding rounds (Garg & Furr, 2017).

Standard board composition	Inside directors: CEO and possibly other executives
	Outside directors: investor directors VC, CVC, possibly founders who are no longer executives, independent directors (consultants, market experts, lawyers, entrepreneurs, academia)
CEO	High ownership alignment with the firm
Outside directors	Well informed in the sector, have financial incentives (preferred stock for investor directors, common stock for others)
Key goals	Rapid growth and exit in the form of IPO or M&A
Board structure	Frequently informal board leadership structure (i.e., no board committees and often no board chair)
Board size	Small, although it can increase over funding rounds

2 Venture Board Process

To understand board processes, it is fundamental to understand how key board-level actors (i.e., CEOs and other board members) adapt to their board roles and adjust them in ongoing engagement with each other. For example, the appointment of inside (non-CEO) directors is often considered a tactic to counter-balance the power of outside directors. This board role, however, is likely to create conflict for non-CEO inside directors as they balance the need to present a united front with the CEO by staying quiet/agreeing with the need to exhibit original, independent, and creative thinking on critical board issues. Similarly, outside directors may need to learn to separate their conflicts of interest as investors or as industry executives or entrepreneurs. Furthermore, these conflicts of interest may be complicated by the varied time horizons and commitments of time and money by different types of directors. Given their sectoral knowledge and strong financial incentives, these directors often must curb their tendencies to micro-manage venture executives. Overall, understanding how various types of board members can effectively adapt to their board roles is likely to be central to board effectiveness.

Furthermore, a board process opportunity is to examine how directors manage core business dilemmas on an ongoing basis. Many strategic decision domains are related (Gaelweiler 1987). For example, new product decisions involve trade-offs between speed, quality, quantity, profitability, and growth. How venture directors make these interconnections across decision domains is important, especially given their commitment to the venture. A related dilemma focuses on the distinctive functions of the board. For example, when and how should board members focus on resource provisioning versus monitoring (Furr et al., 2017)?

These challenges force top management to compromise; to manage contradictory facts while finding solutions to numerous issues: Is revolutionary or evolutionary change required? Does the company require central or decentralized organization? Does it pay out more to focus on the market or on technology? How much autonomy are employees to be given? These and other contradictions must be clarified: efficiency or effectiveness; price or quality; top-down or bottom-up; task- or people-orientation.

Rarely is orientation towards one pole optimal, however, since both have their advantages and drawbacks. Rather, central organizational structures, for instance, have the advantage of a common vision, realization of synergies and a more efficient use of resources. Yet growing bureaucracy, inflexibility and lacking client orientation are the drawbacks. Decentralization strives to compensate for these disadvantages by being closer to clients and positively impacting staff motivation and entrepreneurship.

However, in some cases, it can lead to a lack of coordination, chaos, contradictions and selfish behavior by the decentralized units. Consequently, one reaction to these drawbacks would be centralization. An organizational form constantly moves between these extremes. Similar observations can be made with regard to the dualistic concepts of technology orientation versus market orientation, authority versus participative leadership, task orientation versus people orientation, etc.

3 Venture Board Performance

In order to ensure the future in a VUCA-world, the company has to invest to make boards work more efficiently and to increase their performance. What can be done?

3.1 Foster Innovativeness Inside the Board

High-tech startups that are not innovating in and around the board room run the risk of becoming less innovative. Without innovation at the top, companies may come to see less innovation from below. Viewed affirmatively, directors who learn to work with executives on product and service innovations constitute an invaluable – and free – asset during an era when creativity is increasingly at a premium. An international high-tech startup needs a robust set of thinkers on the board who know the market place and can take responsibility for ensuring that its enterprise transcends the ever-present dilemma of innovating or dying. Therefore, bring in outside experts to challenge the board to be proactive, study the competition, and foster innovation.

3.2 Assess each Director's Position on Critical Issues

Startup board members without startup experience or who have never been active in an entrepreneurial environment are a major problem. They tend to act as if they were in a large company in well-established and well-known structures. As a result, they are ill-equipped to operate with performance indicators of high-tech startups in order to develop a new product and reach a scaling stage from scratch.

3.3 Reevaluate and Refresh the Board

Create an independent process to periodically reevaluate and refresh the board. Identify a point person on the board who is accountable for managing the process and following through on recommendations.

3.4 Plan for Board Succession

Develop a succession plan that includes processes for removing underperforming directors and refreshing the board when changes in corporate strategy require different skills and experiences on the board.

4 An Outlook

The governance of international new ventures will be faced in the future with new management trends, like empowering leadership, especially holacracy (Bernstein et al., 2016) or new developments in entrepreneurial financing (Wright et al., 2016). For example, equity crowdfunding allows ventures to have multiple equity investors through internet platforms while remaining private (Bruton et al., 2015). These shareholders, however, are very unlikely to be represented on the board. In fact, in many institutional contexts, boards are not required for these firms. Unlike ventures, crowdfunded entrepreneurial firms usually lack financially motivated domain investor experts who can effectively monitor and advise. Instead, in these entrepreneurial firms with large numbers of equity investors, there is often "direct governance" by which these small investors actively voice their concerns through social media. This practice can be a huge drain on the attention of firm executives and boards at a time when they need to focus on bringing innovation to the market (Lewis-Kraus, 2015). While the emergence of such new forms of financing entrepreneurial firms is exciting, it is blurring the boundaries between private and public governance and the related role of boards of directors.

5 Conclusions

A way to govern the cited dilemmas is to interpret contradictions differently. At first glance, these ideas appear dialectic, when, in actual fact, they are complementary. Market or technological orientation, for example, do not have to be contradictory, as the two dimensions complement each other (so-called "hidden champions"). Similar deliberations can be made with regard to leadership and choosing change strategies.

In the context of dynamic stability and open innovation, a firm's ability to build dual organizational structures for both the creation of innovation and its implementation is essential. To open up the innovation process, especially in the idea generation and design phases, more exploratory forms of organization are needed to provide a maximum of flexibility and knowledge absorption in the innovation process. This includes the capability to identify new knowledge and technologies, cultural openness, dynamic adaptability of the structures and processes, networking skills and collaboration capability beyond organizational boundaries.

The solution for these dilemmas is to govern the company under the philosophy of an ambidextrous organization. The board has to invest in the company's ability to develop and utilize new resources and competences (exploration) and at the same time make efficient use of already available resources (exploitation). Organizational ambidexterity in this context means an organization's ability to create a sustainable organizational capacity by balancing the exploration and exploitation of resources. The organizations have to make choices considering the principal of scarcity of resources and make explicit and implicit choices between the two (Tushman/O'Reilly 1996, 72f.). Further, exploitation and exploration are considered mutually enhancing, so that it is possible for firms to attain high levels of both.

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In times of disruption, venturing becomes a key source of value creation. As new opportunities emerge and existing models fade, entrepreneurs, corporates and investors are eager to explore and exploit those opportunities. Venture governance, i.e. defining, implementing and following a fit-for-purpose model to provide direction and control in the best interest of all stakeholders, plays a crucial role in enabling and ensuring entrepreneurial value creation.

This book presents twelve perspectives on the governance of ventures, bringing together viewpoints from both practitioners and academics. It provides practical insights, introduces new perspectives and invites the reader – whether a member of a venture board, an entrepreneur or an investor – to reflect on their own approaches to venture governance.

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