FULL PAPER

Title: Start-up to Scale-up in UK's Volatile Business Environment: Unpacking Growth of VC-Backed Startups through a Grounded Theory Study of Board Director Behaviours

Method: Qualitative Inductive

ABSTRACT

Some boards facilitate startups with scaling up and achieving exponential growth whereas others leave founders and shareholders baffled on how to get value from them. Having relevant skills, experiences and fitting board processes is often not good enough. What happens inside the 'black box' of venture boards, the fine balance of director dynamics and interactions seems to be the missing ingredient, both in research and in practice. This grounded theory study aims to unpack the growth governing mix of director behaviours in the volatile business environment of the UK. The showcased preliminary findings include a more integrative model, uncovering several novel behavioural and interaction strategies used by directors to perform their formal monitoring and informal adding-value roles in the context of VC-backed boards.

(123 words)

INTRODUCTION

Boards of investor-backed ventures have long been associated with exponential growth, bringing multiplied value for investors and significance for the economics of society (Fried, Bruton and Hisrich 1998, Gabrielsson and Huse, 2017, Garg and Furr, 2017). Similarly to boards of large corporations, ventures boards are hard to access for research as they operate confidentially, behind closed doors (Garg, 2013). Thus, despite their reputation for being able to propel startups to exponential growth, we tend to only hear about venture boards when they fail to meet founder and shareholder expectations with significant consequences (Daily, McDougall, Covin, and Dalton, 2002, McNulty, Florackis and Ormrod, 2013, Garg and Eisenhardt, 2016). For example, following a collapse of Theranos, a self-proclaimed revolutionary in blood-testing technology, its board was highly scrutinised in the media for governance failure to spot and challenge a serious misconduct within the company (Epstein, 2018). Equally, the conduct of boards of some other ventures such as Uber, Zenefits and FanDuel, have only become known after serious questions were raised about director behaviours and accountability in the context scandals and relentless pursuit of hypergrowth (Garg, 2013, Edelman, 2017, Epstein, 2018). There is actually very little known about how boards of successfully growing ventures operate, especially behaviours and interaction of directors themselves.

Venture board composition and structure are usually known since formation. In the corporate governance research literature, these attributes have traditionally been associated with board effectiveness and company's performance (Roberts, McNulty and Stiles, 2005). However, as global corporate scandals so vividly highlight, simply structuring the board with experienced and skilled individuals, should no longer be considered in isolation from behavioural and process aspects of that board. (Roberts, McNulty and Stiles, 2005, Garg and Eisenhardt, 2016, Garg and Furr, 2017). Investor-backed ventures with high growth potential are of huge importance to the economies and in the context of increasingly volatile global business environment, there is an opportunity to rethink the assumptions about using board composition characteristics and as proxies for behaviours and ultimately the performance of firms.

The aim of this research is to explore what happens on boards of investor-backed technology based startups. Specifically, the research is interested in identifying patterns of director behaviours and interactions and explaining variations in that behaviour. The scope of the study includes early stage investor-backed technology startups in the UK. Using grounded theory approach (Glaser and Strauss, 1967), this study has been inductively examining the experiences of different types of directors, including founders, VC Investor Directors and independent non-executive directors (NEDs). The initial results presented in this paper reveal a more integrative model of optimising for growth, highlighting several behavioural and interaction strategies used by directors to perform their roles.

LITERATURE REVIEW

Traditionally, corporate governance research has been concerned with board structures, demographics, board roles and how these link to the overall performance of the firm (Roberts, McNulty and Stiles, 2005). This literature suggests several ways the relationship between the board and performance can be formulated and explained.

Agency theory perspective, for example, considers the board of directors as an operational solution for governing the self-interest driven behaviour, known as agency problem, of a company CEO (i.e. agent) on behalf of its shareholders (i.e. principals) (Jensen and Meckling, 1976). Inherently, agency assumes that the relationship between the board and performance is reasonably direct and can be inferred from demographic characteristics of the board members (Pfeffer, 1983). It further contends that demographic characteristics can simply be used as a proxy for director behaviour and as long as the impact of demography can be explained, agency argues there is no need to be concerned with the underlying processes and interrelations at board and director levels because these can simply be deduced (Zahra and Pearce, 1989, Pettigrew, 1992, Forbes and Milliken, 1999). Fundamentally, agency clearly advocates for structuring boards as strong monitoring mechanisms and aligning interests of agents and principals even if this means incurring considerable costs, known as agency costs (Jensen and Meckling, 1976, Fama and Jensen, 1983, Hillman and Dalziel, 2003, Roberts, McNulty and Stiles, 2005).

From the agency perspective, the key distinct feature of investor-backed startups as opposed to corporations is that there is no or little separation between control and ownership, where both investors and founders have ownership equity in the business (Sapienza and Gupta, 1994; Arthurs and Busenitz, 2003; Zahra and Filatotchev 2004; Garg 2013). On the one hand it may, therefore, seem that the agency problem is somewhat reduced in investor-backed startups as managers are also shareholders. On the other hand, however, research reveals that investor-shareholders and founder-managers typically have a very different attitude to risk and as such their interests may be significantly misaligned and therefore agent's decisions can still be led by self-interest (Sapienza and Gupta, 1994). Consequently, the agency problem would still exist and so the board of investor-backed company should still be structured to align interests and monitor (Sapienza and Gupta 1994). At the same time though, research and empirical works using agency to analyse investor-backed startup boards seem to simply verify the existence of agency relationship between new investor shareholders and founder-owners and explain the reasons why investors employ "more elaborate governance structures for monitoring and control" when aligning the interests of founders with their own (Daily et al., 2002, p.401).

Yet despite a long tradition and a huge influence over national and international policies on corporate governance, agency failed to produce consistent and unambiguous results that link up specific demographic characteristics of the monitoring board and company's performance (Daily, Dalton and Cannella, 2003). Recently its prescribed solutions have been seriously questioned for a lack of insight since the latest economic crisis resulted in failure of major global financial institutions and corporations such as Lehman Brothers and Enron (Kaufman and Englander, 2005, Huse, 2008). It therefore appears, agency as a theoretical perspective, over-emphasises the direct input-output relationship between the characteristics and structure of the board and the overall performance of the firm (Van Ees, Gabrielsson and Huse, 2009). Significantly, this suggests that effective functioning of boards of directors and company performance cannot be assured by simply prescribing how boards should be structured (Johnson et al, 2005).

There is evidence that startup boards are more active and add a huge value rather than merely monitor (Zhang, Baden-Fuller and Pool, 2011). This seem to be captured by another perspective on the relationship between the board and performance, the resource dependence theory (Pfeffer and Salancik, 1978).

In contrast to agency theory, which regards the board of directors as a monitoring solution mechanism to the agency problem, the resource dependence theory suggests the company board should link up to the external environment in order to provide important resources required to maximise the performance of the firm (Pfeffer, 1983, Pfeffer and Salancik, 1978). The theory argues that a company with a board that possesses a high number of links to the external environment and stakeholders, such as customers and suppliers, sources of capital and market or other information, will have a better and faster access to those resources compared to its competitors (Nicholson and Kiel, 2007). The board's main objective, using the resource dependence lens, is therefore to effectively leverage and manage external relations (Zahra and Pearce, 1989).

Since majority of startups are founded by young first time entrepreneurs and desperately lack resources during the initial stages of development, it is argued that resource dependence theory is strongly relevant as a theoretical lens when examining businesses in such context (Gulati and Higgins, 2003, Lynall et al., 2003, Zahra and Filatotchev, 2004). From this perspective, on their journey to minimize risk and resource dependence on the external environment, startups set up boards, attracting directors with skills and experiences highly relevant to the growth of the business. Some studies even shows that attracting a particularly relevant board member can result in a significantly increased value of the startup, however, this would be at a price of giving up founder control either in a form of shareholding or a board seat (Wasserman, 2014).

Resource dependence theory therefore provides a resource-based explanation for the relationship between boards and company performance as directors can bring a wide range of skills, expertise, customer contacts and capital (Zhang, Baden-Fuller and Pool, 2011). However, in the context of entrepreneurial firms backed by VCs, the theory seems to downplay a “potential for damaging appropriation of their resources” highlighting only a cooperative side of parties that act as linkages to the external environment (Katila, Rosenberger and Eisenhardt, 2008, p.31).

Notably, the dominant position of agency and resource-dependence has recently been challenged by emerging in literature behavioural perspective on the relationship between boards and company performance (Huse, 2007, Van Ees, Gabrielsson and Huse, 2009, Huse and Gabrielsson, 2012). This perspective views boards as open systems with multiple coalitions of stakeholders possessing varying weight and power and participating in a complex process of decision-making (Huse, 2007). As part of this process, directors are seen to engage in four types of behavioural constructs, namely satisficing, bounded rationality, routinisation and political bargaining, (Huse and Gabrielsson, 2012). Satisficing behaviour means searching for solutions that are simply satisfactory and not necessarily optimal, owing to various limitations. The limitations are defined as bounded rationality, existing in the moment of the decision-making, such as incomplete information available at the time, specific set of circumstances or cognitive prejudices of the decision-makers (Van Ees, Gabrielsson and Huse, 2009). The framework recognises that board members rely on their knowledge, past experience and lessons, which they routinize and apply during decision-making thus creating environment of learning by doing and experimenting in the boardroom (Huse, 2007). Furthermore, boards, as coalitions of varied stakeholders with their own goals and interests, inevitably engage in political bargaining, not only during resolutions of conflicts but also during cooperation and decision-making (Gavetti et al, 2012). Overall, this behavioural perspective argues that studying director behaviours relating to decision-making processes would enable researchers to better understand conditions for effective corporate governance (Van Ees, Gabrielsson and Huse, 2009).

However, the behavioural perspective on board-performance relationship is still emerging and, apart from a few recent pioneering studies, for example by Voordeckers et al (2014) examining the relationship between board structures and actual board behaviours in SMEs in Belgium, the Netherlands and Norway, it remains largely untested. Moreover, the theoretical behavioural concepts of this framework have been criticised as very hard to test empirically (Van Ees, Van der Laan and Postma, 2008). Nevertheless, although behavioural theory does not yet offer a coherent alternative to the dominant theories of agency and resource dependence, its ideas have been evolving into a new research agenda in response to calls for better understanding of inner workings of the board (Van Ees, Gabrielsson and Huse, 2009).

Since agency and resource dependence perspectives have been dominating the literature so far, the majority of the theoretical knowledge and policy recommendations in regard to boards have been constructed with very little insight from what actually happens on boards, i.e. processes and associated with them behaviours in and around boardrooms (Pettigrew, 1992). Empirically, 99% this research has also been generated using deductive quantitative methods collecting data from company and director databases and without actually speaking with a single board director (McNulty, Zattoni and Douglas, 2013). As illustrated above, it seems directors and their behaviours have a much more implicit relationship with the performance of the firm than previously believed (Van Ees, Van der Laan and Postma, 2008). This paper showcases preliminary findings of a study investigating director experiences on boards of early stage investor-backed startups, uncovering several novel behavioural and interaction strategies used by directors.

METHOD

As discussed above, some early boards propel startups to exponential growth and some destroy value (Zhang, Baden-Fuller and Pool, 2001, Garg and Eisenhardt, 2016). This study investigated experiences of directors on boards of early stage ventures in the UK to uncover patterns of behaviour and factors explaining variations in that behaviour. The lack of theoretical insight into director behaviours justified employing an inductive method for this study (Van Ees, Gabrielsson and Huse, 2009, Minichilli et al 2011, Eisenhardt, Graebner and Sonenshein, 2016). An inductive method allowed exploration of issues in under-researched fields. It is also a well-recognised and powerful insight-led approach to discover patterns of interactions and explain variance in processes that underpin these interactions (Suddaby, 2006, Urquhart, 2013). Most importantly, an inductive approach emphasised the emergence of the theoretical logic from the data which could be used to extend existing theories with strong, data-grounded insights (Eisenhardt, Graebner and Sonenshein, 2016).

Specifically, this study employed the classic inductive grounded theory developed by Glaser and Strauss (1967) and extended further by Glaser (1978, 1992, 1998, 2001, 2011). Grounded theory is defined as an approach to generate theory from systematically collected data (Urquhart, 2013). It is particularly fitting for studying behaviours and processes about which very little is yet known, as it allows the researcher to openly explore a substantive area of interest without imposing pre-conceived ideas about hypothesis-type relationships on the data (Glaser and Straus, 1967, Suddaby, 2006). Despite long-established traditions of research into corporate governance, the field is dominated by quantitative theorising and board operations and director inter-relations are significantly under-researched (McNulty, Zattoni and Douglas, 2013). Given so little is known about the substantive area of interest, the use of grounded theory for in-depth exploration of director interactions was well justified. Grounded theory also allows the researcher to recognise patterns in the interactions among social actors and theoretically account for the interplay between context and circumstances, actions and consequences, and behaviours and outcomes (Suddaby, 2006, Urquhart, 2013). The field of corporate governance research would also benefit from extending the existing theories or develop alternative theories and models in order to "effectively uncover the promise and potential of corporate governance" (Daily, Dalton, and Cannella, 2003, p. 375). The study thus contributes towards not only building much-needed critical mass of all types of qualitative knowledge in the field of corporate governance but also informs theoretical insights.

Most appropriately for management research, the resulting insights from a grounded theory study are relevant and often immediately actionable by practitioners (Jones and Noble 2007, Eisenhardt, Graebner and Sonenshein, 2016). The issue of investor boards effectiveness is very real for startup founders and their stakeholders given the recent scandals of VC-backed larger private companies such as Theranos and FanDuel (Edelman, 2017, Epstein, 2018).

Grounded Theory Procedures

Classic or Glaser grounded theory is notable for its set of specific procedures, most of which are non-optional (Jones and Noble, 2007). Distinctly, data collection and data analysis take place concurrently, systematically and iteratively (Urquhart, 2013). This process broadly follows three stages:

Stage 1. Identifying Main Concern and Core Category

As soon as the first piece of data is collected, it gets analysed via a construction of analytical codes and categories, using techniques of constant comparison and writing memo notes (Urquhart, 2013). The goal of this stage is to identify participants' main concern and a process for its resolution, represented by a core category (Glaser, 2001). Interviews are constructed to be open and explorative.

Stage 2. Selective Coding and Theoretical Sampling

Once the core category is known, coding becomes selective where only core category and categories related to it are coded for and irrelevant categories are abandoned (Glaser, 1978). Further data collection is sampled theoretically i.e. the researcher collects data relevant to core and related categories from the best source of such data (Glaser, 1998). At this stage interview questions become more focused and derive from emerging concepts (Urquhart, 2013). Data collecting, coding and sampling continue until all categories are saturated, i.e. incidents of data do not yield new properties (Glaser, 1978).

Theory advancement is thus progressed through selective coding and theoretical sampling as emerging categories are used to direct further data collection until all relevant categories are "saturated, elaborated and integrated" (Glaser, 1992, p.102, Heath and Cowley, 2004).

Stage 3. Theoretical Coding

Theoretical coding takes place to identify theoretical code which helps conceptualise how concepts related to each other. This is aided by memo sorting and write up. This can take place while theoretical sampling is still ongoing and collection of data is attuned in real time to fit with the theoretical development of concepts and the relationships between them (Glaser and Strauss, 1967). Once the theory is sufficiently grounded, the researcher engages with the literature in the substantive field of interest by relating it to the outcomes (Glaser, 1992).

Despite non-optional procedures, grounded theory offers researchers a degree of freedom by instructing to approach the study with a broad and open research question (Glaser and Strauss, 1967, Urquhart, 2013). Given that there is a limited number of empirical studies on director behaviours in startups, this feature of the grounded theory is particularly enabling for the researcher to be open to discovery. According to the guidance of the grounded theory, the research question needs to identify the substantive area and population but not make any assumptions about the phenomenon of interest (Glaser, 1992, Urquhart, 2013). As such, this approach allows for a discovery of the recurring main concern of participants and how they go about resolving it, thus identifying patterns of behaviour and resulting in an explanatory framework for this behaviour.

The initial **research question** for this study has therefore been simply crafted as follows:

- What are the issues that directors face on boards of investor-backed tech startups?
- How are these issues being resolved?

The substantive area of interest of this research study was identified as early stage investor-backed tech startups within the UK. Technology-based startups develop and bring innovative technological products to market across multiple industries. Typically, they are characterised by rapid product development cycles, scalable business models and the need for substantial Venture Capital investment to fund its high growth ambitions (Garg, 2013). Such ventures are usually founded by first-time entrepreneurs and their boards are normally formed as a condition of investment from the fist VC investor.

The substantive population of this study was board directors. Broadly speaking there are three types of directors on early boards – Founders, independent Non-Executive Directors and Venture Capital Investor Directors, representatives of the investor firms (Garg and Furr, 2017). Sometimes an early board also includes a Business Angel, a private investor. It is not unusual though for early boards to consist of only founders and VC directors (Garg, 2013). VC directors are deemed to play the most crucial role in adding value to startup company (Aksu and Wadhwa, 2010). In situations where multiple types of participants are present, grounded theory recommends starting data collection from the perspective of a single type of participant to identify their main issue of concern. (Glaser, 1992). The issue of concern is typically resolved via an interaction with other types of participants and other parties and so viewpoints of others are also collected and analysed as part of the study, however this typically occurs during the process of theoretical sampling (Glaser, 1978).

DATA COLLECTION

This study used interviews as the main method for collecting data. Interviews with 21 participants were conducted between August 2017 and October 2018. Data collection was carried out concurrently with data analysis, in accordance with the procedures of the grounded theory. The process started with collecting data from a perspective of VC Investor Directors.

VC Investor Directors were chosen from VC firms with funds that invest in early stage tech startups. They were all at Partner or a Senior Director level at the firm and had multiple experiences on boards of investee companies, taking either a board seat or an observer seat. Their experiences included working at different stages of company development, from very early startups to rapidly growing ventures as well as many experiences of venture failures. In total, the study interviewed 12 VC Investor Directors. As the cycle of data collection and analysis progressed, the main concern of participants and how they resolve it (core category) were identified and so the subsequent choice of interviewees was led by needs of the emerging concepts (Bryant and Charmaz, 2007). Thus 6 Founders and 2 independent Non-Executive Directors and 1 Business Angel Director were also interviewed for this study. Guided by the needs of emerging categories, interviewed founders were all first time founders in a CEO or a CTO role, their tech companies were mostly under 3 years of age with one company approaching 7 years. They have been backed by either a VC firm or by a mix of investors including a VC firm taking a board seat. The size of the investments ranged between £150k - £1m. At the time of the interviews the companies were in the phase of scaling up (product, customers or revenue) with boards in place for at least 12 months. Interviewed Non-Executive Directors were either in a role of an independent NED or a Chair in early stage tech startups backed by VCs for at least 12 months. Interviewed NEDs also had experiences on boards of other types of companies ranging from much later stage investor-backed tech companies to non-profit organisations and large corporations. The interviewed Business Angel was an experienced investor, either investing by himself, as part of an angel syndicate or alongside a VC firm and taking a NED or a Chair position at the investee company as a result of the investment.

Interviews

Interviews were conducted either face to face, video or audio skype or telephone. They lasted between 35 and 85 minutes and were digitally audio recorded having obtained a written consent. The interview questions were open-ended and in line with the grounded theory procedures, they were designed to to learn as much as possible about directors' experiences, their possible concerns, reactions, observations and thoughts. Broadly, the initial interviews consisted of three parts:

<u>Part 1. Experiences</u>

In the first instance the interviews opened with 'tell me about your experiences on boards', thus 'instilling the spill' (Glaser, 1992). Picking up on experiences mentioned, several prompts followed 'Tell me more…You mentioned X– could you tell me more about this experience?'

<u>Part 2. Issues of importance and how they got resolved</u>

The second part picked up on issues of importance or significance within participants' experiences, repeating what was mentioned and delving into what happened, how issues were addressed and resolved, prompting for illustrative examples of reactions to the actions from other board members (Urquhart, 2013). Typical questions and prompts included: 'This seemed important to you as director on boards of your investee companies… Why, could you tell me more about this? How did you go about addressing this? Could you tell me more about how this got resolved? Please tell me about the reaction of other directors, founders?'

<u>Part 3. Change in behaviour over time</u>

The third part explored experiences of differences 'When you look at your experiences, could you tell me about a situation where one of your boards did something differently? Could you please describe the most important lessons you learnt through your experiences on boards on boards of VC-backed startups? How did you discover that? Have your views changed over time?'

At the end of each interview the participants were asked about any other information that have not been covered but they felt were pertinent to mention in order to better understand what happens on investor-backed startup boards.

VCs and NEDs were prompted to provide examples from their experiences across current and past relevant boards and founders were asked to speak about their own companies. All participants were encouraged to speak about their own specific experiences, providing real situational examples where possible, rather than giving out an opinion or making general statements.
As the cycles of data collection and analysis progressed, the interview questions were increasingly focused according to the needs of the emerging concepts and theory (Bryant and Charmaz, 2007).

In summary, given the research question, VC Investor Director perspective was chosen for this study as a starting point because it was most likely to deliver on obtaining the variance in behaviours and outcomes as the VC Directors are in a unique position of having an unusually high number of director appointments and would have been able to draw on a vast number of experiences on boards within the substantive population. This type of participant could also draw on their experiences of failed companies and companies at later stages of development. The data received from VC directors was supplemented by data from other types of startup board director to get the fuller picture of what's happening on boards of early stage investor-backed tech ventures.

DATA ANALYSIS AND RESULTS

This study followed the procedures of Glaser's grounded theory and so the analysis of data took place simultaneously with its collection. During the initial stage, the purpose of the analysis was to discover the "informants' main concern and how they seek to resolve it" (Glaser, 2001, p. 177). This was done by employing a key grounded theory principle of constant comparison of data incident occurrences to one another and then grouping similar incidents into codes and categories (Glaser, 1998). Constant comparison of data and the discovery of the main concern were assisted by asking questions "What category does this incident indicate? What property of what category does it indicate? What is the participant's main concern?" (Glaser, 1998, p.140). At the same time, memos were written to note relationships and connections between categories, properties and codes, and to develop conceptualisations.

Not surprisingly, given the substantive area of interest is early stage investor-backed startup boards, the data revealed that the central essence of participant concerns pertained to ***growing exponentially***:

> *"Ultimately needing to secure growth in the portfolio company is the most important thing for a VC."*
>
> *"We are trying to grow huge companies."*
>
> *"What we are after is not necessarily profit but big growth."*
>
> *"The growth curve had to hit a certain range."*

Along with the main concern, initial interviews uncovered several patterns of behaviours and actions. Using memos and further analytical comparison with new interview data, these were coded and organised into categories, providing a rich base for conceptualising, which is necessary to identify the core category.

Core category in classic grounded theory is a category that relates to all concepts, suming up what is going on in the data (Glaser, 1978). Its identification is judged and confirmed by extensive criteria;

core category must be central and related meaningfully to all others, occurring frequently in the data and accounting "for a large portion of variation in a pattern of behaviours" (Glaser, 1978, p.95). Informed by this criteria, extensive memoing helped reveal a process-type core category which expressively explained the connection between all other emerging categories and concepts. Inductive discovery of the main concern and core category is the main reason why grounded theory is so valuable when investigating unexplored areas, such as boards of directors, especially since processes and behaviours of directors are partly shaped by a legal responsibility, partly by wider interest of investors in the context of founder's lack of experience.

As such, to resolve their main concern, i.e. make growing exponentially possible, the data revealed that directors engaged in behaviours and actions revolving around a process of ***optimising***. This process contained three distinct stages – ***validating, behaving bigger*** and ***realigning.*** Each stage was characterised by a set of actions, conditions and consequences. During validating, directors confirmed gaps in systems and teams, and probed the founding team for the level of understanding the value and benefits of governance. Outcomes used during the next stage, behaving bigger, when directors engaged in attuning systems, processes and communications and filling gaps in executive and non-executive teams. At a decision point when further funding was required, directors made judgements about execution and performance, considered cognitive capability of the founder and asserted power with significant consequences to startup and its team which ranged from startup failure, CEO replacement to new investors and realignment and re-start of the optimising process.

Once core category was identified, data analysis and coding became selective, supported by collecting data by sampling theoretically according to the needs of the emerging concepts and model. This process continued until categories were saturated, detailed and linked up (Glaser, 1992). Table 1 illustrates the evolution of organising codes into final categories.

Table 1. Evolution of Organising Categories into Final Categories.

Preliminary Organising Categories	Final Coding Categories	Optimising for Exponential Growth Core Category Stages
Skills and Experience Gaps Examining Performance indicators Systems and Processes Gaps	Confirming Assumptions	Validating
Understanding Governance Recognising Board Value	Understanding Value of Governance	
Structuring boards Formalising governance processes Asserting Reporting Expectations	Formalising	Behaving bigger
Balancing Evolving board norms Communicating	Attuning	
Encouraging experiential habits Future focusing Prioritising strategic role	Aligning Mindsets	
Taking long term view Considering portfolio Judging execution Assessing cognition	Judging	Realigning
Influencing HR (Human Resources) Aligning power Growing up	Asserting	

The following sections discuss each stage of the optimising process in more detail.

Validating

Data shown that post-investment, directors engaged in validating a 'fit for purpose', i.e. ability to grow exponentially. This included confirming structural and cognitive gaps in the team and the company:

> *"My focus from day one is get in there and work out whether it is going to be fit for purpose and if it's not, you are going to be needing to put all those processes and systems in place." (structural)*
>
> *"a lot of it is in their heads and they haven't committed down into a formal style." (structural)*
>
> *"They don't really have almost the mentality or the culture of it." (cognitive)*

Data suggested that post-investment, directors engaged in various degrees of validating their pre-investment assessments. This happened in addition to the extensive pre-investment due diligence on the startup and its founders when gaps were typically identified and planned to be filled as a condition of investment.

Structurally, directors focused on confirming gaps in skills and experiences, examining performance indicators and gaps in systems and processes. As participants said:

> *"Success to me is when all of the skills required or represented on the board either in executive or non-executive capacity."*
>
> *"Often on boards, you are looking to bring that in experience on how you grow and scale software companies from a commercial sense rather than from a technical sense."*

Structurally, directors also examined if startups used most suitable indicators when tracking and reporting performance:

> *"What are the right metrics that are going to give you advance notification. Are we looking like we are going to be on track or not."*
>
> *"He examined the KPIs and he decided whether they were the right KPIs."*

"He first and foremost tested if that KPI is relevant and it was."

"What are you measuring in the company right now? What metrics are you measuring for your customers and how are you going to educate them?"

Cognitively, directors explored whether the founders had a real understanding of the functions of the board and the purpose of governance, not just as a legal entity with fiduciary duties and responsibilities but specifically recognising it as bringing benefit and value. As some participants said:

"The number one priority is to make sure the CEO understands what's the function of the board is and a lot of them don't."

"In the very early stages a lot of the CEOs don't really value the board meetings and the input of the board."

"They don't necessarily understand what's the benefit is."

The CEO's understanding and recognising that boards bring value and benefit and are there to help rather than monitor was indicated by the data to be a meaningful micro-foundation for the development of the board into value-adding board as opposed to a monitoring board. As participants noted:

"There are a lot of CEOs think of it more as governance rather than helpful and it is self-fulfilling prophecy because if the CEO does not value the board, the board doesn't really get much out of the CEO and the meetings are all just going to be a waste of time."

"They start off thinking that the board is checking up on them and if that's the case, you almost certainly will turn into that kind of a board."

However, data also indicated a variation in director effort that went on verifying cognitive gaps vs verifying structural gaps. Focusing much of the effort on identifying and filling gaps in skills and experiences of executive and non-executive teams suggested they were used as a proxy for resolving cognitive gaps.

Behaving Bigger

In the process of optimising for growth, validating stage is followed by behaving bigger:

> *"The main thing, as I say, behaving as a bigger company before you are one."*
>
> *"You need to start pretty early and make sure you've got all of the stuff in good order."*
>
> *"You want your reporting and everything else to be able to be scaled quicker than you can scale the business."*

This stage was characterised by a wide range of changes taking place internally within the company and externally. Internally, for example, as well as working on technological and product development, startups' executive and non-exec teams were changing, with new people joining and existing people taking on wider roles, inevitably leading to new relationship dynamics. Externally, at the same time, startups were experimenting with different 'go-to market' strategies, in order to grow their customer base and revenues. These changes placed founders under unique set of pressures to deliver on expectations within extremely unstable and ever-changing internal and external environments while at the same time, for most of them, this was their first instance dealing with any of that.

In such pursuit of exponential growth, the purpose of behaving bigger stage in the process of optimising was to ensure the startup and its team were structured and were behaving as a much bigger company than they actually were. Therefore, structurally, during this stage directors focused their attention on **formalising governance** and **attuning board norms**. Cognitively, directors were concerned with **aligning the mindset** of the board members and founders.

Formalising governance as soon as possible was highly important to investor directors. It consisted of implementing changes to the structures and processes of the governance function:

> *"We need to build an exec team, build a non-exec team, build the whole board, formalise it and structure it properly."*
>
> *"you're having not just to bring the governance but also think about who should be on the board what role should be on."*

“you’ve got to get that [governance] right first and foremost.”

Having confirmed assumptions about structural gaps during the validating stage, formalising typically included structuring the board by bringing new non-executive directors or replacing existing ones and asserting expectations for reporting and communications.

Data revealed a significant variation in the style of how formalising governance was implemented. As such, structural changes were simply a typical condition of investment and therefore startups had a legal obligation to get on with. For example, such obligations included forming a board if they had not already had one, taking on a NED agreed by the investor or provide information monthly in a specific format and follow prescribed board meeting schedule. However, some changes were heavily influenced by investor preferences:

“I put a really challenging character on the board as a non-exec, I’ve worked with him for [a number of] years, so I know what I’ve got there.”

“We have templates and things like that which we provide.”

“Put together a template of this is what we think a board pack should look like.”

On other occasions, completely to the other side of the scale, changes were done subtly, in full consideration of not only the gaps in skills, experiences and systems, but also of the management acceptance and approval of the changes:

“You’ve got to do things very, very slowly, very subtly. You’ve got to almost get the management team to buy into that.”

Data also revealed that formalising governance, i.e. installing systems and processes to be structured and to behave as a bigger business, had to be balanced. This is because using large company’s reporting mechanisms could be over-burdensome and unnecessarily resource-intensive for a startup with a very small team where all board paperwork is probably done just by the CEO:

"We follow the template that [Venture Capital Investor] provided, which sometimes can feel a little bit unnecessary."

"The investors they had no idea how much effort went into preparing the material for the board meeting."

"It was a wake up call for them as well that just to cover just a check, they made the CEO to spend half a week just preparing the pack."

Having said that, the quality of the reporting information and its timeliness were revealed to be very important to the directors since, not surprisingly, installing templates for board reporting did not necessarily lead to the provision of quality information and board schedule and agenda did not by themselves ensure quality and valued discussions. Essentially, board norms needed attuning to the needs of all directors and at the same be of value to the startup and the founder. Therefore, the outcomes of formalising were attuned over time.

Data showed a connection between the level and depth of attuning board norms and the characteristics of the communication processes between board members. Very little attuning happened when communication was limited to the formal governance mechanisms of board reporting and board meetings. In contrast, a deeper understanding of the business developed when both board directors and the CEO were making time for more regular communications. Making time was thus revealed as a strategy for attuning, as participants said:

"CEO has weekly calls with all the board members, just to make sure that that gap doesn't mean the board is very disengaged."

"Half an hour every week to kind of catch up and talk about the things that they are thinking about."

"If you are in touch with the CEO, you don't get surprised."

"What I'm trying to do is to have a deep enough understanding."

As opposed to:

> *"I'm obviously running this fund and my interaction with any of the portfolio companies is limited to board meetings."*

Alongside formalising and attuning structurally, an additional activity of behaving bigger stage was revealed to be aligning cognitively. This related to aligning of the mindset of all board members. During the early stages of startup development, boards were perceived to have two functions: strategic and governance. The governance function was very important to investors, as supported by strongly asserted expectations for reporting and board norms as part of the legal obligations of the company. At the same time, during behaving bigger stage the significance of the governance function in relation to growing exponentially was almost dismissed by directors, including investors themselves. As some of the participants said:

> *"Obviously you've got your various little duties to ensure fiduciary and you know director responsibilities to the company but that's no any good to anyone."*
>
> *"If you think corporate governance is your role on the board, you are missing the point."*

In contrast, directors really valued the strategic, adding value role of the board and their approach was to make sure all members on the board understand this:

> *"Being helpful for the company's side, and to me that's the most important thing."*
>
> *"You've got to get mindset on the board should be about helping, facilitating and optimising not about egos and corporate governance."*
>
> *"A common understanding on board that they are there to help, rather than to check up what's happening."*
>
> *"I think what's most detrimental is where the members of the board are not properly aligned."*

As such, aligned mindset to be helping, facilitating and optimising rather than just monitoring was considered as a micro-foundation of an effective board. As one of the participants said:

> *"And if you manage to achieve that you've probably got a very effective board"*

Directors used several notable behavioural and interaction strategies to align mindsets. These included encouraging experiential habits and future focusing. For example, data revealed it was not unusual for some directors to take on in a mentoring or a coaching role which they used to encourage founders develop experiential habits highly associated with the characteristics of becoming a successful entrepreneur:

> *"I encourage them to be themselves rather than work towards the same format."*
>
> *"Catch up and talk about the things that they are thinking about, act as a sounding board and, you know, it is there as a tool for them primarily."*
>
> *"I don't have any right or wrong answers necessarily, but just talking through the problem is often more helpful than leaving it to one person to solve it on their own."*
>
> *"I to try and introduce some balance and thought into what to do next."*

Since most founders at that stage were first time founder, it was also important for directors to help them develop into CEO, by encouraging them to take responsibility for their own success:

> *"I make it clear to the CEO, it is their meeting, so they set the agenda whether formally or informally."*
>
> *"[it] is for the CEO to use the experience of directors to optimise the decision making of the company"*
>
> *"I always encourage my Chief Execs and the other people around the exec team to reach out to the non-execs and the chairs outside of meeting and really tap into them."*

Overtime, the more and more experienced CEO develops a natural skill to think through and talk through decision options and become very specific in their asks from the board.

Future focusing was another important strategy to align mindsets for growing and optimising. Directors used it to maintain forward visibility and focus on growing exponentially:

> *"I think one of the key things to try and get good forward visibility of the progress of the business."*
>
> *"A really important function for the board is to help with, you know, raising your eyes to the horizon and you look further out."*
>
> *"Trying to get a good picture of 12-18 months into the future, what do the company financials look like, when might more funding be required."*
>
> *"Start to project forward to say, alright, here is what the trajectory looks like and what we are going to do to maximise it or reverse it or whatever you need to do."*
>
> *"The main question that they asked us at the last board meeting, start putting objectives around when are you going to start scaling. If we gave you a million pound what would you do with it?"*

In summary, behaving bigger stage in the process of optimising revealed several behaviours, actions and strategies as micro-foundations of effective adding value boards. These included formalising, attuning and aligning. At the same time, the results offered several explanations for the variation in director behaviour, for example focusing much of the effort on formalising and using it as a proxy to enable attuning.

Realigning

The final stage in the process of optimising for growth is realigning. The stage was triggered by a need for more investment funding. As such, the need for further external investment was somewhat inevitable since exponential growth could not usually be funded by profits or other internal resources within the startup company. Also, growing was just one of several possible reasons for triggering the need for more investment. The other scenarios included anything in between needing more time to get to market or failing to commercialise all together. Regardless of the type of the scenario, during this stage, directors broadly engaged in two activities: judging performance and execution, and asserting power.

During judging, directors evaluated the performance of the company and the emerging track record of the founding team to execute on strategy. However, while judging, Investor Directors' behaviour was somewhat distinct from the behaviour of independent Non-Executive Directors. While Non-Executive Directors followed their fiduciary duties and acted in the best interest of the company, the actions by Investor Directors were characterised by taking a long-term view on the capability of the company and its team to deliver exponential growth and therefore returns on investment. At the same time, Investor Directors also considered their investment portfolio and relative size of their exposure and risk. These considerations shaped actions they asserted alongside their fiduciary duty. For example, regarding the need for more funding, their actions then ranged from following on the original investment, or making an offer to co-invest with new investors, or completely withdrawing from the new investment round.

One of the consequences of asserting power was a consideration whether the management team was the right team for the job (Golden and Zajac, 2001). As participants put it:

> *"there is always the question, if the company is successful, is founding team the right team"*
>
> *"And at that point, all the investors were kind of aligned, [...] and I am sat there thinking, are they just going to throw me off soon."*
>
> *"We just thought the founders didn't really have the experience to take the company forward at the pace it needed to go. So trying to professionalise it, brought in this other guy."*

This appeared in stark contrast to the formalising, attuning and aligning activities of the previous stage of optimising where CEOs were encouraged to value the input of the board, use them as sounding board, make time to develop a trusting relationship and generally, come to regard the board as a safe place. The boards of directors, of course, have the ultimate power to replace CEOs and at this stage, it seemed to be a real consideration even if startup was growing.

The data highlighted several properties pertaining to growing exponentially. It revealed that exponential growth is volatile in nature, unstable in speed, requires multiple performance indicators to confirm.

At the outset, growth does not reveal itself as a linear upward curve. Also, it does not necessarily come at fast speed and requires more than one performance indicator to identify it. For example, a rapid growth in a number of users of an application does not necessarily mean a growth of revenue. As one participant said:

> *"we could see rapid growth in user number stats and then it was just a matter of trying to convert those and locking down a business model that would convert the user interest into a revenue generating activities, which the company did through, an iterative process"*

Growth was also indicated by a transformation within the startup company, it expanded, professionalised and felt like a 'grown-up' company, as expressed by participants:

> *"When you go into the office and it is suddenly like a grown-up company. There are all these people here, and you don't know what they do."*
>
> *"You suddenly like 'oh wow' this is actually real now rather than a couple of people in a broom cupboard somewhere."*
>
> *"It feels like a vibrant living thing."*

To summarise data analysis, the results revealed that, fundamentally, directors on boards of investor-backed tech startups focused their concerns on growing exponentially. Consequently, they engaged in a complicated process of structural and cognitive optimising through stages of validating, behaving bigger and realigning. Data revealed patterns of behaviours and actions within each stage of optimising and variations in the behaviour. The optimising process was culminated by a significant event of either securing or failing to secure further external funding. Data suggested that in case of securing funding, which saw new investors brought in and therefore new board members installed, the process of optimising restarted.

The next section adds to the discussion of the emerging model of optimising for growth.

DISCUSSION: EMERGING MODEL OF OPTIMISING FOR GROWING

The preliminary results of this study revealed that directors of early stage investor-backed startups engage in the process of optimising which takes place over several stages. Director activities and behaviours appear to converge around structural components of the business and cognition of the executive and the non-executive directors. The emerging model offers explanations for the variations in director behaviour during each stage. Distinctively, some of the variation arises when structural changes are used as a proxy for cognition. The model suggest directors and boards of startups with high growth potential should invest in cognitive costs, such as, for example, understanding the value of the board, aligning mindsets and encouraging experiential habits, alongside agency costs, which for example include structuring, formalising and asserting reporting expectations (Wirtz, 2011).

Several observations of the model at each stage also revealed micro-foundations of an effective investor-backed startup board. Consequently, this would allow to construe how board directors should be behaving and how boards should be functioning that would enable them to be more effective in their adding value role (Forbes and Milliken, 1999). Table 2 below summarises these micro-foundations.

Table 2. Micro-foundations of Boards

	Effective	**Ineffective**
Structural		
Quality of information	Attuned	Poor
Type of reporting	Outcome reporting	Activity reporting
Timeliness of reporting	Adequate	Inadequate
Level of director preparation	High	Low
Quality of discussion	High	Low
Board meeting focus	Strategic	Reporting
Communication	Regular	Limited and formal
Cognitive		
Recognising board value	Positive	Negative
Mindset	Aligned	Misaligned
Value adding	Explicit focused	General common sense

	Effective	Ineffective
Behavioural strategies		
Challenging Future focusing Applying pressure Debating	Constructive Brainstorming Keeping the sense of urgency Achieving consensus	Aggressive Chasing numbers Demanding Unsustainably disagreeing

Limitations of this study

The study is exploratory and inductive, not hypothesis generating and testing. The emerging model is explicitly provisional and at this stage the results would apply to the substantive are of interest of early stage investor-backed technology based startups in the UK. The results indicated that the process of optimising restarts with new investment round, indicating that an exit event or becoming a 'grown up' company would holt or transform the optimising loop. However, the boundaries of this have so far been outside the scope of the study and therefore have not been explored.

CONCLUSION

Board operate behind closed doors and investor-backed startups are no different. However, some of them are clearly able to boost the growth of the company and others are not. Demographic characteristics of directors are no longer regarded as trustworthy indicators of effectiveness and performance. This paper showcased the preliminary findings of the grounded theory study into a more complex relationship between director behaviours and processes on boards of VC-backed technology startups in the UK. The results indicate a novel and more integrative model of behaviours, structural and cognitive processes as part of a optimising for exponential growth. The results also revealed valuable practical insights into the effective micro-foundations of adding value boards, which are immediately actionable for boards, directors and especially founder-directors (Eisenhardt, Graebner and Sonenshein, 2016). The next step in this research would be to move from substantive theory grounded in this one particular context of early stage, investor-backed, technology-based startups, to a conceptual level with more general implications and relevance.

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