

Creating a Board of Directors: Key Considerations for Startup Companies

Article By:

Keunjung Cho

One of the most important decisions that a startup entrepreneur can make is creating a board of directors that will assist the entrepreneur in growing and governing the business. A company's board of directors is tasked with overseeing and advising management, making key decisions about the company's business strategies, and representing the interests of the company and its stockholders.

Initial Considerations

When forming a board of directors the startup entrepreneur should first consider the size, structure and skillsets of the proposed member(s). While it might be fairly intuitive that the board should consist of an odd number of directors (so as to avoid a voting tie) and a small enough number to avoid inefficiencies (so as to facilitate coordination of meetings and make feasible action by consent), one should also consider the extent to which the board composition will reflect the ownership interests of the company and whether the board should include an independent director from the outset. While it is customary for a startup company's board seats to be given initially to investors, an independent director with expertise in the company's industry area may provide helpful, disinterested advice as well as the necessary "tie-breaking" vote where consent of a majority is required to take action.

Business Considerations

Board members can provide valuable advice to startup entrepreneurs and help the entrepreneur avoid costly common mistakes. Board members can also fill in any gaps that a startup company has in certain areas of expertise, such as sales and marketing or finance until the company is financially able to fill those roles with fulltime employees. In addition to the skills and background of each individual director, the combined skill set of the board as a whole should be considered when directors are brought into a company. As a group, the board should possess a balance of business and financial expertise, technical knowledge of the industry area(s) relevant to the company, directorship experience on other boards, and ability to devote sufficient time to the affairs of the company.

Legal Requirements

State Law

Most companies are incorporated in Delaware, whose applicable statutory provisions give broad authority to directors in their oversight of a company's operations and do not delineate specific qualifications that a director must have. Delaware law is also silent as to board composition and independence requirements of directors.^[1] Thus pointing to Delaware as the example, the main considerations under state law are a director's abilities to fulfill his or her duties and obligations to the company, which include the duty of care (making informed decisions on behalf of the company and acting in good faith) and the duty of loyalty (acting in the best interests of the stockholders and the company, avoiding self-dealing, and disclosing any potential conflicts of interest). In the case of startup companies, the latter consideration may prove the most relevant, as investors in the company may wear several hats.

Long-term Considerations

If and when a company considers going public, it should be mindful of corporate governance rules put forth by the various stock exchanges, including the New York Stock Exchange (NYSE), Nasdaq and the American Stock Exchange. The exchange rules are largely aimed at establishing director independence and creating boards with a majority of independent directors. The exchange rules lay out tests for determining independence, including those related to compensation arrangements and other material relationships between a director and the company. NYSE and Nasdaq both require listed companies to have a majority of independent directors and further lay out independence requirements with respect to various committees of the board, including the audit, compensation and nominating and governance committees.

Other Factors

When putting together (and growing) the board of directors, a company should also consider intangible factors such as diversity and the assembly of a group of directors that will collectively offer a variety of perspectives and opinions on company decisions while maintaining a culture of open communication.

[1] See Delaware General Corporation Law, 8 Del. C. § 141(a).