Chapter 2

THE PEOPLE

People, people, people.
-Arthur Rock

It is often said that the three most important factors in real estate are "location, location, and location." Likewise, the three most important factors in the formation of start-up companies are "people, people, and people," because it is the people who lead the firm and have ultimate responsibility for its success. The key personnel are the chief executive officer (CEO) and those immediately adjacent to him or her in the reporting structure-i.e., the board of directors above the CEO and the team of direct reports below him or her. Although the board of directors has the ultimate fiduciary responsibility for the company, it is the CEO who is responsible for leading the firm, since the CEO leads the team members, who, in turn, lead the vital functions of engineering, manufacturing, marketing, and sales.

The requirements for the board, the CEO, and the team change somewhat as a company matures, and a person or group of people who may have been right for one stage of a firm's development may not be right for another stage. Each of the following sections starts by presenting the time-independent general requirements for a given position-beginning with the most important of these positions, that of CEO-and then discusses possible flaws and more specific requirements, including how these requirements may change between the concept stage and the seed stage.

THE CEO: LEADER, COACH, MANAGER, AND "STANDARDS SETTER"

The CEO sets all the standards for the company, including coaching, decision making, delegation, effort, egalitarian behavior, energy, ethics, hiring, honesty, leadership, management style, quality, thoroughness, and working style-i.e. the complete A-to-Z range of attributes that form "the corporate culture." The CEO, in short, is the firm's heart or "clock," which drives every event.

Academics, biographers, and autobiographers have written a great deal about the personal characteristics required to start a company and become its first CEO. Silver (1985) believes that the typical entrepreneur is a happy, creative, insightful, guilt-laden twenty-seven- to thirty-three-year-old who is a good communicator, comes from a middle-class home with an absent father, had a deprived childhood, is married or divorced, and can focus intensively for long periods of time.

It should be noted that wealth was not among the characteristics just specified. Not only does Silver not require it, but both White (1977) and I believe that "being wealthy is a significant handicap" to an entrepreneur because success isn't absolutely essential for wealthy people, and they are therefore not driven by an urgent need to acquire and preserve cash. In the words of Jim Hammock, president of Silicon Compilers (acquired by Mentor Graphics), "When we started up, the company was all any of us had. We simply had to make it work. Often, fear of failure was our strongest driving force." It is possible to create the appropriate fear of failure in a wealthy person, however, and thus overcome the "handicap of wealth," by having that person invest a significant portion of his or her net worth in the new venture. The CEO must have a very high energy level and be completely dedicated to the company. Dedication means that the CEO should not be involved in more than one or two outside organizations, since excessive outside involvement is irresponsible and places his or her firm at significant risk. On the other hand, neither should the CEO be overzealous-trying to do everything personally. Rather, the CEO must be able to hire creatively, understand the responsibilities of every team member, and delegate tasks appropriately. If the CEO is the founding entrepreneur, and is an inventor or marketing visionary but not a manager, he or she may wish to delegate a majority of the tasks through an intermediary manager-a chief operating officer (COO). Under these circumstances, Silver (1985) advises hiring a manager who is older and more formal, who has a great deal of energy and heart, and who is both practical and thorough. Typically, a good manager for this position is a former corporate achiever with a nonegocentric mind-set who became dissatisfied with his or her environment.

Having both a COO and a CEO in a start-up involves a number of potential dangers, however. This is essentially a "two-in-a-box" style of management, and the

COO and CEO may try to perform the same tasks, tripping over each other while increasing costs and slowing decision-making. Alternatively, the CEO may delegate too much responsibility. Ideally, the CEO should rely upon the COO as one of the chief members of the team to whom tasks can be delegated, but the CEO should never delegate his or her primary responsibility, which is driving the company.

Another way to get into difficulty is to have a chief operating officer who manages internal affairs while the CEO sells the company in various ways. Such an arrangement stresses "selling" as a CEO's most important skill and thereby biases the choice of a CEO, by limiting the field to candidates with a sales background. Unfortunately, such individuals often find themselves incapable of hiring outside the sales specialty and hence tend to populate the company with salespeople. Although a CEO (and the rest of the team) should have some sales ability, the need for such ability pales in comparison with the need for him or her to understand finance, control, marketing, and products. Further, unlike a salesperson, who leads and manages individuals, a CEO must create, lead, and manage teams of individuals. In short, I believe that those involved in a start-up should think very hard before selecting a salesperson or sales manager as a CEO.

Over time, I have concluded that the chief executive officer is typically the weakest dimension of a start-up. The CEO holds a position of great influence, since systems and controls for running the company smoothly are not yet in place. Resource limitations compel the CEO to wear a number of hats, frequently in areas where he or she has little expertise. One of the important hats is often that of mediator, because intrateam disputes can have immediate (and possibly devastating) bottom-line ramifications. The fledgling organization's inordinate dependency on the CEO places a great deal of power and responsibility in this individual's hands perhaps more than he or she has ever exercised. Some CEOs get drunk on this power, while others become frightened and paralyzed. Good CEOs are able to maintain a certain measure of detachment and perspective and understand the need to drive the organization.

The following list presents some key personal qualities exhibited by effective CEOs. Readers are encouraged to rely on their own experience and intuition when weighing them.

- *Intelligence and energy:* CEOs need intelligence so they can identify and prioritize problems and set direction, and they need extraordinary stamina and commitment because everyone in the company takes his or her lead from above. When it comes to these two qualities, the higher a CEO's level of intelligence and energy, the better.

- *Integrity, quality, and working habits and environment:* CEOs must be honest and open in dealing with everyone, inside as well as outside the company. They must set a personal example that translates into both corporate and product quality.

- *Openness*: CEOs who encourage an "open-door" policy, invite suggestions for change and solutions from anyone, anywhere, and who are willing to openly acknowledge their strengths and weaknesses tend to be good, honest leaders. They have no "hidden agendas" and demonstrate a realistic, appropriate pride in their accomplishments. They usually get things done through the natural processes of building interpersonal respect and recognizing competence.

- *Background:* Good training and good role models, or mentors, are two of the most common attributes of effective CEOs. The problem is that the great companies don't let their people escape. Thus, many of the available CEO candidates may be the products of an inferior corporate background and inferior professional role models. The best alternatives are often "virgin" candidates with no preconceived company concept.

- *Team-building skills and ability to delegate:* These attributes, which are actually closely related to the team dimension, involve the CEO's personal ability to create, motivate, and drive the team in a productive and organized way.

- *Ego and humility:* Excessive ego or lack of ego can lead CEOs either to consistently fail to delegate authority and responsibility, or to chronically overcommit or undercommit to accomplish personal and company goals. CEOs must therefore be able to restrain, but not eliminate, their personal and professional pride. The accuracy of the CEOs' assessment of the company's (and their own) strengths and weaknesses gives an indication of their true humility.

Just how critical is CEO selection? Dennis Gorman of Sevin Rosen found that over 90 percent of the companies backed by his firm that went public were still headed by the original CEO, whereas 25 percent of the companies that failed or were floundering had retained the founding CEO.

In summary, James Swartz, past chairman of the National Venture Capital Association, describes five attributes that a CEO needs to "win a venture capitalist": leadership, vision, integrity, openness, and dedication.

CEO FLAWS

CEOs' flaws are legendary, as countless newspaper and magazine articles have chronicled with delight. Some CEOs have been victimized by technology's moving more slowly than they anticipated; others have met their fate at the hands of a fickle buying market; still others have simply been losers. Unfortunately, the authors of newspaper and magazine stories tend to simplify the issues by concentrating on single events or single flaws and do not provide a holistic view. Book authors, in contrast, have more time for research and more space to tell the story. As a result, some books do provide a balanced picture of the right attributes, and many booklength biographies and analyses present case studies illustrating effective CEO performance.

The flaws summarized in the following subsections are, in effect, the reverse of the virtues listed above. Since no one is perfect, the CEO is likely to exhibit at least one of these flaws to some degree. How the start-up deals with a CEO's flaws is very important, because a company that is weak in other dimensions may find these flaws to be fatal. A flawless CEO is a rare phenomenon; however, Ken Olsen[1] (Rifkin and Harrar,1988) comes as close to this ideal as any CEO with whom I have worked, and his record of success is legendary.

Low Energy, Low Intelligence, and/or Low Integrity

The CEO may have either a low energy level (slow clock) or an inadequate time commitment, low intelligence (what might, in computer lingo, be termed a slow central processing unit, perhaps coupled with a small 640K memory), and/or questionable ethics. This type of CEO tolerates nonegalitarian behavior, low quality standards, poor work habits, and umestrained company spending.

The criticality of the CEO as the standards setter-the individual who establishes the company's clock-was discussed earlier. Almost all the dimensions encompassed in this flaw, ranging from intelligence and work habits to ethics, have come up in "judging" every CEO I know. A particularly annoying flaw for start-ups is the CEO who treats the fledgling company as if it were a large, solidly established firm, demanding all the perks. Individuals of this sort are readily identifiable, since they insist on a large salary, absolutely must fly first class, require a carte blanche expense account, and tend to be found quibbling over (or modifying) their original compensation agreements with the company. Arrogance and greed drive such CEOs to milk the very firms they were hired to nurture.

My own biases are clear: only become part of a venture led by a hardworking, extremely intelligent, and highly ethical individual who knows how to establish a dynamic, open company culture and can manage, lead, and sell.

1. Digital Equipment Corporation started in 1957 and ran well under Ken Olsen's leadership until the rnid-1980s, when the advent of other forms of computing began to stall the company. Product revenues for 1990 declined from the previous year, and in the fourth quarter, the firm was unprofitable.

Inability to Sustain the Cheerleader Role

The CEO may lack the stamina, energy, and ability to continually sell employees, customers, and investors, throwing in the towel when the company fails to take off. Given the brutal environment of a start-up, the CEO can never abdicate his or her job as head cheerleader.

Inadequate Hiring Skills

The CEO may be unable either to make first-rate hires or to deal with the inevitable hiring mistakes. Because this type of individual simply doesn't know how to test for and hire top-quality people, he or she often just hires former cronies, placing more stock in allegiance than in competence. The company must continually seek and hire only the best candidates. If the CEO is unable to accomplish this, then "pygmy hiring" sets in and the quality of the firm's personnel enters a downward spiral.

Poor Managerial and Team-Building Skills

The CEO's lack of managerial and team-building skills can manifest itself in numerous ways. The company may operate in a state of continual chaos; the CEO may reserve all control and decision making for himself or herself, thereby preventing any of the subordinates from managing or developing; or the CEO may work all issues one-on-one so that a team never has the opportunity to form and team problem solving never occurs. This type of CEO may create either a "political" environment in which every decision hinges on the selling power of individual personalities or a bureaucracy in which decisions take forever to be made.

The CEO who places a high value on "being liked by everyone" will probably create an environment in which staff-level decision making is impaired or futile. At the other extreme is the tyrant who insists on taking and keeping control of every area of the company personally, thereby impeding all progress. The CEO sometimes does this overtly, by delivering imperial mandates at staff meetings; but he or she can also achieve the same effect covertly, by allowing many issues to be left unresolved. In the latter case, the CEO then avoids confrontation by "solving" these issues outside of staff meetings, without buy-in from the parties who are most affected.

Above all, the CEO has to understand the fundamentals of leadership and management. He or she must be able to delegate, form a team, and get the team to make extraordinary commitments.

Inability to Build a Team or Keep a Team Together

It is sometimes possible to detect a lack of team quite readily. A venture capitalist I know simply asks a direct question of a team member. If the CEO interrupts with an answer, he suspects that the company is driven from the top down and lacks a viable team.
When the founder and CEO is unable to keep the team together, he or she may be ousted by a "palace revolt" and replaced by a series of ill conceived, board controlled actors and actions. For example, I know of a company that built real-time laboratory computers based on the first 32-bit microprocessors. After two years, when the firm was just beginning to reach its peak sales and was becoming profitable, a "palace revolt" prompted the board to replace the existing CEO. The new CEO came from a very large computer company but was a sales-oriented individual with no experience in the laboratory market area or in product development. The organization subsequently declined to the point where it was forced to merge with another floundering firm. Guess who the winner(s) were: (a) investors; (b) the founding CEO; (c) the new CEO, who received a "golden parachute"; (d) all the founders and employees; (e) customers; (f) none of these.

Inability to Sell the Company to the Financial Community: The "Short-Socks Test"

A start-up may fail to secure funding for many reasons, not all of which are necessarily relevant to the firm's viability. The following is a case in point: After visiting an entrepreneur, a New England venture capitalist commented to his associate that the company wouldn't be funded. "Why?" asked the associate. Replied the capitalist: "Because the president was wearing short socks." Although I'm sure that lots of California firms have obtained funding despite their founders' wearing no socks at all, the basic principle still applies: when an entrepreneur is initially seeking financing, first impressions really count-perhaps more than they should.

Regardless of whether the precise reason for the CEO's inability to sell the startup to the board and the investors is trivial (e.g., failing the "short-socks test") or substantive (e.g., not being a sufficiently persuasive advocate for the company), his or her shortcoming will manifest itself through financing problems for the firm and a lack of belief in and/ or support for the CEO. This flaw really involves an inability to manage the board and the investors. It is perhaps the most rapidly fatal flaw of all those discussed, and its cost is quite simple: the CEO loses his or her job when an impatient board finds it isn't getting the response it believes it needs.

CEO RULES

In some cases, a company is founded by an entrepreneur who has a technical or marketing idea and who then serves as the acting CEO during the firm's seed stage, even though he or she may lack many of the required qualifications. This is a risky way for a company to start out, because it may subsequently be forced to hire a new CEO in order to reach more advanced stages of its development, and the transition to the "real" CEO can prove traumatic. Changing CEOs is similar to performing a heart transplant: it takes a long time to find a compatible donor, the operation is lengthy and complex, the body requires a long period of healing and adjustment afterward, and there are no guarantees that the procedure will ultimately be successful. It would be much better to search for an appropriate CEO from the outset, using the rules in this subsection as guidelines.

Does the CEO candidate possess the levels of intelligence, energy, ethics, and quality that are required to establish the clock and culture for the proposed company?

Although this rule can be stated explicitly, it is never really answered explicitly. It is answered implicitly, however, by everyone-employees, investors, strategic partners, or customers-who becomes associated with a particular start-up. Despite its being wholly subjective, this rule tests the overall quality of a CEO candidate by evaluating the individual as the prospective leader of the environment that he or she proposes to create.

To satisfy this rule, the CEO candidate must provide solid evidence and references that testify to his or her past accomplishments. In particular, if a prospective CEO has run another company and has led in the definition of its culture, then the new firm is likely to be similar to his or her previous one. As the start-up ends the seed stage, it will become increasingly clear to the employees, investors, strategic partners, and customers-as well as to the CEO himself or herself-whether the CEO was well chosen.

A second, less subjective rule should also be applied to the concept stage selection of a CEO:

Has the CEO demonstrated management, team-building, and leadership ability involving product development, in a resource-constrained environment, and on a do-it-from-scratch (e.g., start-up) basis?

This rule really has three parts, since being able to manage, team-build, and lead are all highly critical skills. Without managerial skills, the CEO will be unable to establish any standards of commitment and follow-through. However, as discussed earlier, the CEO could satisfy this aspect of the rule by delegating management tasks to a COO, provided the company can afford the extra staff and there's a clear understanding that the CEO is in charge. The second part of the rule tests whether the CEO has experience in technology and product development. The final part tests his or her ability to operate with constrained resources. Ideally, the prospective CEO will have gained that skill during a previous start-up, but a person who has begun a small enterprise within a large company might be an alternative candidate, albeit a risky one.

Can the CEO articulate and sell the company vision to attract the financing, engineering, and other key talent needed for the (advanced or predevelopment) seed stage?

The final rule for the concept stage evaluates the CEO's ability to act as a salesperson in order to obtain seed stage financing and recruit outstanding employees so that the seed plan can be carried out.

Does the CEO have extensive experience in management, and has he or she demonstrated competence in product development, marketing, and sales by adhering to the principal objectives of the seed plan?

This rule provides a simple test based on the CEO's most recent accomplishments during the seed stage. Given the seed stage requirement of translating unique technology into a product specification, it should be easy to determine whether the CEO has in fact been successful in leading the company to this point.

Is the CEO a leader and team builder across departments, and can he or she lead/manage the team and help attract key personnel at various phases of the product development stage? This will be necessary in order for the company to start building all the required functions.

This rule looks beyond accomplishments during the seed stage and examines the likelihood that the CEO can continue to be an effective leader and manager during the firm's future stages of growth. It is a rule that is often violated, because many entrepreneurs do not have the time to receive management training (or to gain its equivalent in terms of practical experience) before they begin running a company. It is hard for an inexperienced CEO to manage a fledgling firm and get funding at the same time. Michael Dell of Dell Computer and Bill Gates of Microsoft were inexperienced CEOs who succeeded, but they did not have to obtain traditional funding, which is fortunate, since their youth and lack of experience might have made it difficult.

Has the CEO been successful in attracting financing, recruiting key employees, and finding directors for the board?

The ultimate proof of the CEO's selling ability is whether key individuals have signed up at the seed stage. There should be a "backlog" of people wanting to be involved in the company.

Does the CEO have insight into the content, scheduling, and management interdependencies of engineering and marketing in the early phases, and of manufacturing and sales in the later phases?

In order for the CEO to build a team, he or she must understand the motivation of the various functions and know how to get the team's members to work together and resolve the conflicts that will inevitably arise. A good test of the CEO's skills in this regard is whether both engineering and marketing have agreed to the product specification by the end of the seed stage.

Can the CEO function actively as a company missionary in preselling, negotiating strategic alliances, and lining up codevelopment partners during the product development stage?

As noted earlier, a CEO must be able to sell the company to investors and the financial community. Beyond that, however, he or she must also be able to sell to customers and potential partners. In some cases, the "ideal" selling target is a strategic partner who can invest in the new venture.

THE TEAM AND COMPANY CULTURE: THE PARTS MUST FUNCTION AS A WHOLE

Lack of team is the number one company killer.
-John Shoch

Although teamwork is a critical aspect of an organization of any size, it is especially important in a start-up. Teamwork is like a tree, with communication as its trunk and with mutual respect and recognition of common goals as its major root structures. The leadership necessary to nurture teamwork starts with the CEO and his or her direct reports, each of whom leads a team effort within a particular functional group. Although each direct report/group is measured independently, the groups must realize that they form a team and that the results of the total team are what count. There can be no such thing as saying "Your end of the boat is sinking."

Without integrated team effort, the company will be unable to understand and resolve all the critical issues that cross organizational boundaries. Some of the issues (financial compensation, working environment, product quality) require the mutual efforts of several groups, whereas others (product pricing, materials sourcing) can be resolved by special pairwise relationships between groups.

Table 2-1 lists some crucial tasks that call for high levels of formal cooperation and coordination.

To achieve the level of teamwork required to form and grow a successful company, it is important that the top-level team (direct reports to the CEO) consist of high-quality individuals with measurable experience and expertise. The head of the startup’s engineering department must have proven expertise in the company’s technology /product domain; in addition, he or she must be able to perform a function, such as design or analysis of some portion of the design. The top-level team must also be "do"-oriented rather than "management”-oriented. Each member must be able to “play" several positions on the team that reports to him or her rather than just managing the team. This requirement implies specific kinds of competence and serves to ensure that:

- Members of the top-level team have an appropriate level of competence, ruling out bureaucrats who come from large companies and possess the necessary credentials on paper but often lack actual competence

- The department head really knows what's going on in the department, since he or she functions as an active participant instead of just serving as the "boss”

- The organization is lean right from the start, since it does not have the separate line (brawn) and staff (brain) components characteristic of many large, “fat" companies

A top-level team that passes these tests demonstrates competence, and competence is the basis for respect. Respect among the collected heads of the various groups will ensure that they function as an integrated team rather than as a collection of egocentric or warring individuals.

Even though the team operates in an integrated manner, each of its members still has his or her own contributions to make. The measure of a team's success is how the contributions that its members make through their individual roles combine to produce an overall result that is greater than the sum of the separate contributions,

Table 2-1. Tasks Requiring Teamwork.

Task	Involved Organizations
Define the product for customers	Engineering/marketing
Manufacture the product	Engineering /manufacturing
Control the order-to-product flow	Sales /manufacturing
Provide marketing information and establish order flow	Marketing/sales
Resolve customer problems	Service/manufacturing/engineering
Meet corporate and departmental operating and financial objectives	All departments / financial organization
Maintain a commitment to corporate quality	All departments

due to the synergistic effect of teamwork. Table 2-2 summarizes the unique roles played by various individuals as members of successful teams in some well-known start-ups.

RESPECT FOR EMPLOYEES AND THEIR PERSONAL TIME

The new company's attitudes about how people will be treated begin to develop during the seed stage. One of the most important and visible of these attitudes involves the work ethic, as embodied in the firm's working hours. A start-up must strike an appropriate balance so that participants can have a life beyond the firm. The successful start-up is often staffed with twenty-five- to thirty-five-year-olds whose families, including young children, can't understand why they never see their parents. It is unreasonable to establish a company culture in which, from the outset, employees are routinely expected to work over eighty hours during six or seven day weeks. One reason why a firm should avoid overscheduling its employees is that it will have no slack-nothing to fall back on when the inevitable real crises arise. However, the main reason for avoiding overscheduling is that burnout can occur when employees work at such a pace for two to three years.

Hundred-hour weeks are inevitably required in even the best-managed startups, but they should be the exceptions. In many new companies, staff members find themselves working at least part-time on Saturdays, and it is not uncommon to hear

Table 2-2. Roles of Key Individuals in Several Well-Known Start-ups.

Company	Person	Roles
Apple	Jobs	Founder, driving entrepreneur, and product visionary
	Wozniak	Founding engineer and product designer
	Markula	Cofounder and source of financing and business expertise
	McKenna	PR, unofficial member of executive staff, and board of directors
	Rock	Funding and board of directors
	Scott	First president
Microsoft	Gates	Founding technical leader and visionary
	Allen	Technical Cofounder
	Balmer	Engineering operations
	Shirley	Business, marketing, and operations
Apollo	Poduska	Founder and company leader
	Nelson	Product visionary
	Greta	Product design
	Spector	First president until steady state
	Vanderslice	Second president, bureaucrat, sold floundering company to Hewlett-Packard
Intel	Grove	Operations
	Moore	Overall visionary
	Noyce	Visionary and external spokesperson
Lotus	Kapor	Founding president and product visionary
	Manzi	Second president, during steady-state growth
Sun	Khosla	Founding entrepreneur and first president
	Bechtolscheim	Hardware product designer
	Joy	Software product designer and UNIX visionary
	McNealy	Manufacturing, with transition to president
	Lacroute	Operational management

investors remarking about the number of cars in the firm's parking lot on evenings and weekends. In short, the start-up has a responsibility to establish reasonable expectations with regard to workload and to clearly communicate those expectations to job candidates before they join the organization.

RESPECT FOR THE INVESTORS' CASH AND THE COMMITMENT TO PROFITABILITY

The firm's attitudes about spending are another key part of its culture. Ideally, the start-up should have a virtual reverence for cash, minimize spending (this includes keeping salaries down), and maintain a clear focus on profitability. Investors respect a new company that borders on being miserly. In contrast, they worry about a company whose employees rake in high salaries and fill the parking lot with expensive cars when the venture is not yet profitable.

I recently visited a chronically unprofitable company whose employees have created a culture in which profit is disdained as if it were an unethical concept. The organization, staffed with many talented artisans, came from a government-funded research laboratory and now builds creative animation software, which it must sell in order to survive. This firm must ultimately change if it hopes to remain viable, since even the most gullible investors reach the point where their patience wears thin and their purse snaps shut.

TEAM FLAWS

Because a team can be undermined by almost anyone on it, the responsibility for a team's success lies with every one of its members. Whether or not those involved can operate as a team depends on such factors as the extent to which they share a vision of how to build a lasting company, the competence of the individual team members, the team members' respect for one another, and the CEO's leadership skills. Since a discussion of all possible team flaws could fill an entire book, this subsection describes only some of the most common ones.

A Mercenary Team

The problem with building a team using entrepreneurial mercenaries is that the members' motivation will be questionable. If the team's aim is simply to make a quick buck rather than to develop a unique technology and form a lasting company, difficulties will soon ensue. A similar flaw, forming a company with a questionable motivation, is discussed in Chapter 3, "The Business Plan."

Conflicting Egos and Lack of Respect

In some cases, certain key participants, including the CEO, may be so egocentric that the CEO cannot form them into a viable team. The first test of a group's ability to work effectively together as a team is when it has to prepare the company's business plan and make trade-offs among various functions. If there is a problem with conflicting egos and lack of respect, the team may simply fall apart at the concept stage or the seed stage because of its members' inability to get along while preparing the plan. Alternatively, the team may break up during a later stage of the company's life, when the stakes are much clearer and the pressure for teamwork is even greater.

Lack of mutual respect is usually at the root of this flaw, although the problem may give the outward appearance of ego conflict between the involved individuals. It is common in high-tech organizations to find a lack of respect between marketing and engineering personnel, which is almost certain to prevent effective teamwork. Every possible effort must be made to overcome this flaw because although mutual love is not a criterion for team membership, mutual respect certainly is.

TEAM RULES

The team is more than the sum of the founders or those who report to the CEO. Although the CEO is ultimately responsible for the company culture, the entire team must embody it. Team members must help define and promulgate the culture throughout the firm by their actions. The likelihood of forming a successful team can be analyzed by applying the rules presented in this subsection.

Do the two or three people currently “on board" at the concept stage have the critical experience and expertise in technology/product/market development?

The first rule tests whether the team has the individual and collective professional capabilities to start up. Unless each member exhibits an outstanding level of professionalism, the company does not have a solid foundation, and the lack of competence and mutual respect is likely to prevent the formation of a team.

Is there evidence that the founders can function as a team? Tests: Have they worked together productively for three to six months? Do they respect one another?

The second rule checks for what might be termed "teamness" at the concept stage. Without solid professional competence on the part of each member, the team will not function cooperatively to solve the inevitable conflicts, such as disagreements between engineering and marketing over the product requirements. This rule also tests how compatible and comfortable the individuals are with one another in terms of whether they can engage in joint problem solving and trust one other to manage their respective areas. The simple tests include the team members' having worked with one another long enough to be certain that they can build a company together. Some investors insist on the team's having worked together either in a previous job or for at least six months on the current start-up.

Does the team's orientation reflect an appropriate balance between "doing" and "managing" that will enable it to begin establishing an action-oriented culture? Tests: Can each of the top-level team's members "play" one or more positions on his or her team as opposed to just managing a team of players? Has the team managed comparable undertakings before?

This rule requires each member to function both as an individual contributor and as a manager. Unlike managers in large, established companies, managers in start-up firms invariably spend significant amounts of their time personally performing their department's function, so they should be technically capable. On the other hand, they should also possess managerial skills, since it is hoped that the company will ultimately grow to the point where they will function primarily as managers. It is, of course, difficult to find technological creativity and sound managerial ability in the same person. Whenever technologically creative individuals discover that they are weak in management, their first priority should be to hire their own boss.

Do the reputations of the concept stage team serve to attract a first-rate engineering team along with the critical marketing resources necessary to achieve seed stage and product development stage objectives?

The team must have the individual and combined reputations (in terms of skill, charisma, etc.) that will enable them to hire the critical people who will actually form and carry out the company's main functions.

By the end of the seed stage, are the core leaders for the technology development, product development, critical-process manufacturing, and marketing functions on board? Are they operating as an integrated team of six to eight people?

This rule, which provides yet another assessment of team formation, is tested continuously during the seed stage, when the team members have an opportunity to work together for several months-a vital step in team building. It is extremely important that the founders be able to function as a team. If they show mutual respect and the CEO is a good leader, chances are they will form a successful team.

By the end of the seed stage, have hiring criteria been established? Is a systematic recruitment method in place?

Although each of the functions is responsible for recruiting in its respective area, having companywide standards is also important to ensure that the first employees are operating according to a single set of principles in establishing the company culture. In start-ups, it is very easy to erect arbitrary walls and create different classes of corporate "citizens" based on the way individuals are rewarded by various managers. No matter how hard a firm may try, salary and stock ownership are likely to become widely known. Although egalitarianism is not mandatory in order for a start-up to be successful, rewarding on the basis of skill makes for a happier environment.

By the end of the seed stage, if innovative manufacturing processes are required (such as in semiconductor or disk manufacturing), is an experienced manufacturing leader with a core team of functional specialists on board?

If the company must undertake a manufacturing-intensive development process, then the manufacturing leader must be part of the key hiring and team-building effort right from the start.

By the end of the seed stage, have team members defined their desired corporate culture? Is it compatible with what can reasonably be expected, both from the company's people and in terms of the overall professional working environment in the firm's geographic area?

All companies attempt to create a corporate culture that is uniquely their own. The two key aspects of culture that must be defined at the outset are how the company will treat its employees and how it will manage cash (the ever-present symbol of its investors).

Interested readers can find many books and articles that discuss the culture formation process and/or analyze the culture of specific companies. Deal and Kennedy (1982), for instance, have described various aspects of corporate culture, including the case of Tandem Computers, which has the highest regard for its employees and is well known for its creative, healthy environment and its nearly unique culture. Rogers and Larsen (1984) have described the culture of Silicon Valley, and their work is required reading for anyone starting a venture there. And finally, In Search of Excellence (Peters and Waterman, 1982) is the best-known book on the subject.

THE BOARD OF DIRECTORS:
REVIEWERS, COUNSELORS, AND COMPANY MISSIONARIES

The board of directors has the ultimate fiduciary responsibility in a company and thus the ultimate responsibility for selecting the CEO. However, once the board has chosen a CEO, its members should function only as reviewers and counselors rather than trying to run the CEO's company for him or her. The only time the board collectively, or its members individually ,should play an active role in the firm's day-to-day operations is during those rare periods when the position of CEO is vacant. Arthur Spinner of Hambro International Venture Fund summarizes the relationship between the CEO and the board like this: "If you are a venture capitalist [on a board] and you want a company to run, go start one yourself."

Spinner also cautions, "If you are an entrepreneur and you need direction rather than support, you should not be running a company; you should be working with one." However, at various stages of the start-up's development, the CEO may have occasion to call on the board for review and counsel. Assistance may be required initially in obtaining financing and later in taking a company public. Advice may be needed in such areas as product and market development or selling to key customers. The wisdom of experience may be useful in dealing with control and operational problems. In each case, the board may provide its advice and counsel by asking hard questions and may help the firm achieve a more realistic perspective by offering an alternative point of view.

Choosing board members is a critical process, because some may become directors for life, and each must be considered a vital part of the company. Unfortunately, the composition of a board is frequently linked to financing, because many venture capital firms make funding contingent on their being granted a board position. In such cases, the member is often unable to make any contribution beyond cash. Selecting board members based on their ability to come up with money or work harmoniously with the CEO is usually a bad idea; rather, board members should be selected based on the expertise that they can contribute. Even then, it will be rare for a board member to have a broad range of applicable expertise unless he or she has run a similar organization. I believe that a start-up should avoid choosing board members who have not participated in the operation of a company or who possess only a single area of expertise, such as the ability to raise money (unless it is unquestionably clear that they can bring in cash easily).

Cautions have also been expressed about board members whose sole area of expertise is the law. According to Gladstone (1988), many venture capitalists feel that "practicing lawyers make poor directors of small businesses" because "businessmen…will help reach a consensus…[whereas] lawyers do not bring harmony to the boardroom."

A homogeneous board should be avoided, since this type of board is unlikely to have the perspectives that a new company needs in such diverse areas as consists of six near-clones is a recipe for disaster, because each member has the same limited outlook. In fact, Spinner even argues that it is helpful for a board to have at least one "renegade of sorts who will consistently play devil's advocate."

In contrast, a heterogeneous board is the ideal (although heterogeneity should not be carried to the point where board members cannot work together harmoniously or communicate effectively). Such a board will find it easier to engage in a variety of activities, ranging from simply serving as a support structure to shaping external perceptions of the company (as Ben Rosen did for Compaq and Lotus). It might also be useful to enlist members who have experience in working with troubled firms and increasing their valuation.

The start-up should select board members who can spend the time necessary to They should understand the business well enough to detect danger signs and recognize opportunities. Thus, people with time to do the job right may be much more valuable than well-known individuals who already sit on a dozen or so other boards.

When selecting board members, quantity should be considered in addition to quality. Rosenstein et al. (1989) did a study of 162 start-ups in the northern California, Boston, and central Texas areas, which revealed that board size tends to increase as a company progresses from stage to stage in its growth process. (See Table 2-3.)

Of the 162 companies studied, the average board had 5.6 members, of whom 1.7 were internal members, 2.4 were venture capital principals, 1.2 were venture capital staff, and 1.8 had various other backgrounds. As companies grow, so do their boards, and large, established firms have a mean board size of 13 persons.

The rather large representation of venture capital people on the boards surveyed may be cause for concern, given the caution voiced earlier. However, it should be remembered that the caution was against selecting board members exclusively as sources of cash. If the company can find venture capitalists who have demonstrable

Table 2-3. Board Size Versus Growth Stage.

Stage	Average Board Size	Standard Deviation
Seed	3.7	0.5
Start-up	5.0	1.24
Financing rounds 1, 2, and 3	6.0	1.50
Financing round 4	6.0	1.40

expertise, they can make a valid contribution to the board. For example, in addition to providing financing, these individuals can serve the firm in such capacities as the following:

Developing the firm's original strategy	Monitoring operations
Acting as a sounding board	Monitoring financial performance
Recruiting and/or replacing the CEO	Evaluating market plans
Recruiting (other than the CEO)	Establishing customer contacts
Securing debt financing	Developing new strategy
Securing equity (outside of venture channels)	Serving as an interface with vendors
Serving as an interface with investor groups	Assisting with crises

The value added by venture capitalists in performing these functions (as perceived by the CEOs) was also tabulated in the Rosenstein et al. study. The study concluded that venture capitalist board members made worthwhile (but not outstanding) contributions, with the greatest contributions being made in the earlier stages of company development. Also, no correlation was found between how well the firm was doing and the CEO's assessment of its board, although the ordering of the perceived value of each function did change slightly. Other functions performed by the board were listed, too (evaluating product/market opportunities, formulating marketing plans, developing compensation plans, and assisting in the initial public offering [IPO]), but these were deemed to be of negligible help. Steve Coit of Merrill, Pickard, Anderson, and Eyre suggests that the venture capitalists on the board are really the vice presidents in charge of financing and the IPO.

In order to maximize the board's usefulness, the CEO must know how to manage the board. For instance, the CEO should always raise issues rather than adopting a defensive position. He or she should take care to meet the board's expectations, which means exceeding the requirements of the plan. Being prepared, especially for the very first meeting, is essential. The agenda should include information about progress and a summary of key issues that need to be dealt with. In addressing key issues, the CEO should propose a plan for review as opposed to asking for advice. The CEO who asks for advice will get it, and the CEO who does so too often will find that the board or one of the directors is running the company.

Board meetings should be conducted in an atmosphere of openness. Both Spinner and I believe that the company's vice presidents should attend board meetings to make them aware of the board's views on various issues and to give the board insight into the company's management team, one of its most important assets. In contrast, CEOs who guard access to the organization are likely to be either hiding something or insecure. In exchange for the CEO's policy of openness, the board should deal with the CEO fairly and honestly, without wasting his or her time on petty matters. Board members must realize that the CEO's time is a precious resource, which they should conserve.

BOARD FLAWS

Individual competence is at the root of having a great board of directors, just as it was a key factor in having a great team. Not utilizing a competent board is merely a lost opportunity, but certainly not a fatal flaw. The most serious flaw in this dimension is simply having board members who are unable to contribute to the company, either because they lack an understanding of the industry or because they possess no knowledge and have only an ordinary level of intelligence. (The inexperienced venture capitalist usually falls into the latter category.)

One of the CEO's most important jobs is to keep the board appropriately informed and involved in the firm. Thus, the company must have a relatively competent and cohesive board of a manageable size (about six or fewer members). When the company goes out of control by missing its plan and board members are surprised, the board oftentimes becomes involved in day-to-day operations.

The balance of this subsection describes typical board-related problems that every start-up must guard against.

An Investor-Heavy Board with No Industry Experience

A board can have a very negative effect on productivity if it demands that the company conduct its operations in a way that pleases the board instead of in a way that will help the firm become a successful provider of goods or services. An especially naive board composed of individuals who have had scant operational responsibility or who have a very limited understanding of the industry is likely to have a net negative effect by creating "make-work." One such board that I know of contains a member who has no product, market, or technology experience and is unable to make any valid contribution. Rather than having this individual tutored "off-line," roughly 30 percent of the board meetings are spent in his education.

A Board That Runs the Company

As noted above, when a board finds itself surprised by missed plans or faced with operational uncertainty, it may get involved in the day-to-day management of the firm, usurping the functions of the CEO and his or her team. A board that exhibits this flaw is the riskiest type of board for the CEO to face, because it is just a step away from firing the CEO.

No External Product/Market Review

Although the company's product/ technology should routinely be subject to outside review as the start-up develops its business, this may not be occurring because of such factors as (1) an uninformed or inexperienced board, (2) the lack of a technology advisory board (TAB) or customer advisory board (CAB), or (3) operational negligence on the part of the CEO and his or her team.

Every company needs an appropriate review mechanism to help direct its efforts. In the case of an established firm, customers automatically provide such a review through the marketplace. In contrast, a start-up is like a newly launched missile, in that it must first be aimed in the right general direction and its trajectory must then be continually corrected in midcourse if it is to reach the intended destination. If board meetings are held only sporadically and communication with the board is erratic and ad hoc, the board is typically out of control.

BOARD OF DIRECTORS RULES

A formal board of directors is usually established with the first round of investment. Although investors will naturally want to make sure the company is in control and help it achieve its goals, granting board membership to inexperienced investors (or to any other inexperienced individuals) won't help the firm in the long run.

During the seed stage, the board should be structured to review the start-up's product and market plans in order to provide advice that will ensure the birth of a healthy company. A customer or technical advisory board should also be established during this stage.

The following are the key questions that the start-up must address in setting up its board of directors and its CAB or TAB.

Have board members with expertise in the key strategic areas outlined in the business plan been identified to serve during the seed stage and later stages?

Although it is inappropriate to have a full-scale board of directors during the concept stage, the company's founders should have some idea of whom they would like and should have approached these individuals as the funding is finalized. During the seed stage, the board will no doubt be composed of the two or three founders and one or two investors. Since the goal of the seed stage is to reduce risk and plan the start-up, it is worth having this critical sounding board to weigh ideas about the start-up's future direction.

During the concept stage, formal technology advisory and customer advisory boards are probably inappropriate. However, if the company is entering an area where the technological risks are especially high or where certain critical strategic partnerships must be formed as part of the start-up process, it is prudent for it to be working with a small group of key outsiders who will ultimately advise and assist the firm during the seed stage and later stages.

Is a technology and/or customer advisory board in place by the end of the seed stage?

This rule about having a functioning technology and/or customer advisory board by the end of the seed stage is related to the preceding rule about having identified potential board members with expertise in key strategic areas. It is becoming increasingly common for start-ups to have a TAB and/or a CAB composed of experts who understand the technology and advise the company on the formation of the development team, reviewing the status of the technology and the competitiveness of the proposed products. I recommend a single board composed of both builders and users that meets regularly and whose members play an active role in advising the firm, including serving as paid consultants.

The CEO must attend TAB meetings because they perform a critical review function and provide feedback that the start-up may not get in any other fashion, since its potential customers are often unwilling to tell the company's marketing staff the truth about their products. Also, the market input may get garbled as it passes through various individuals who are grinding their own axes and who may be unable to communicate effectively with engineering. A TAB should be free to conduct its critical review of the company's technical and applications directions without restrictions that may hamper its effectiveness. No topic should be off-limits, including how the firm designs products, to whom it sells, or how it conducts its business.

By the end of the seed stage, does the board include members who have appropriate operational experience related to product and market development in addition to the investor representatives?

At the seed stage, the board is likely to be overstaffed with investors whose only function is to keep an eye on their money. An ideal board would contain no more than two investors, the CEO, and one or two outsiders. The two investors should have. previous operational experience in related businesses. The outsiders should have experience in the product, service, or market area and should have invested enough through sweat or equity to ensure that they are involved and concerned.

In 1990, most venture capital companies are staffed with people who have had successful operational experience. This reflects a change in the composition of these firms that occurred in response to the often-expressed criticism that they were staffed with fresh MBAs who had no previous experience in operations or in the industry. Although being lucky in a few previous deals is a necessary prerequisite, it is not in itself a sufficient qualification.

CONCLUSION

The CEO of a new start-up was lamenting to his board about the difficulty of hiring. A wise venture capitalist advised: "It's not only hard; it's your only job, because if you are successful, everything else is easy." The top-level people-the CEO, the team responsible for carrying out the major functions, and the board of directors-constitute the start-up's three most important dimensions.

The CEO establishes the standards for the company and serves as its team leader. The vice presidents for engineering, manufacturing, marketing, and sales are the "CEOs" for their respective functions. This top level of management must operate as an integrated team and "drive" the organization to achieve its business plan and establish a healthy company culture. The CEO reports to the board of directors, where the ultimate fiduciary responsibility for the venture rests. In the ideal firm, the board merely helps and advises the CEO and company rather than participating actively in the start-up's management.