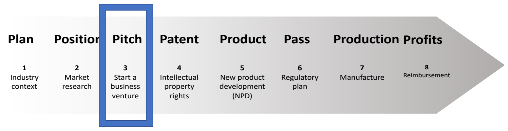

Chapter 3: Tips on Starting A New Venture – Building your team and board and transitioning from the lab

1. What's the first step to starting a new venture with my idea?

The first step to starting a company, or starting to write a business plan, is to bring together a team (2 or more people). With a good team you can make magic happen even if your idea turns out to be a pumpkin. If the innovation is excellent, like a top-of-the-line, superbly balanced canoe, but the team is not capable and cannot move in one direction together, the canoe has a poor chance to survive any perturbation, let alone make it to the finish line. Working with a partner/teammate will give you another perspective and push you to explicitly flesh out your idea and its commercial use.

2. How do you find a co-founder or early hires?

Recruit team members or co-founders by pitching the concept in business plan competitions or pitch days at your local incubator or startup forum and announce your hiring needs. Investors and incubator personnel may be good sources of available talent. Selection of team-mates at the management level can be based on gut feeling or chemistry with the people, as well as logical fit within the gaps in the founders' skills or a fit for the company's future needs. Willingness of the person to join a startup pre-revenue is often a self-selecting factor for motivated team members. Using job description criteria can help screen people, but hiring people and assigning roles on the basis of aptitude, not only on experience or degrees, usually pays off in a growing company where roles and needs keep changing and people often wear multiple hats.

If you are the scientific founder, it is usually helpful to select a co-founder who is going to be the business lead in the team. The titles of CEO or CTO or COO are less important than assigning the specific functional roles and responsibilities to the co-founders.

3. How do we distribute equity when founding the company?

A simple solution is to distribute equity evenly if all co-founders are taking the same risk in going full-time. Else weighting mechanisms like assigning points to domain expertise, key contributions, responsibilities, and time commitment can be used to apportion equity. Weighting mechanisms serve to open doors to a detailed conversation among founders about expectations and commitments. Either way, all equity grants must vest over time. While you can combine a milestone-based and time-based vesting schedule, in general, a time-based vesting is best as specific milestones may change rapidly as the company learns and adapts it plans.

- Data from 29 cancer therapeutics companies in USA (founded from 1997-2017 with exits from 2004-2020) provide a view into common share (founders) equity ownership and valuation over multiple financing rounds. At series A, founder shares had average 40% ownership and at IPO < 10%, while value of founders shares went up from average $3.5M at Series A to >$25M at IPO.

- Senior academic advisors or professors who are staying in their position but giving their contacts, reputation and some time to help the company move forward are usually best placed to join advisory boards rather than the board of directors. Depending on the amount of time they promise to give the company, options or shares to advisory board members range from 0.1% to 0.5% for a few hours commitment to the company each month or up to 1% if much more involved. Vesting is over 2 -3 years typically with no cliff or a short 3-4 month cliff.

- Use of a capitalization table service like Carta, Figure, Ledgy and several others that are now available can be very helpful to manage the cap table and compliance issues, typically engaged after the first seed round is closed. Many of these services will also provide a 409(A) valuation which is required for the company to issue options. A corporate lawyer experienced in startup companies will usually provide a template for cap table or advise on the use of 409(a) valuations.

Recommended reading: Venture Deals: Be Smarter Than Your Lawyer and Venture Capitalist Hardcover (2019), 4th edition, by Brad Feld, Jason Mendelson. Wiley Press.

4. Transitioning from Academic lab scientist to Startup company CEO /CTO

The science feels like it is the same process, but the context is completely different. In academic science, the experimental path often meanders as new things are learnt . Papers are presented as linear narratives, but hypotheses can be refined and reworded after the last result is obtained to fit a neat story. The goals in the company are mainly to meet the next milestones, where criteria for success are specific and pre-defined. The selection of commercial scale Industrial tools with an emphasis on reproducibility, scalability and speed are a different set of values where in academia, greater emphasis is on customizable tools. Pursuing interesting data to pull a rabbit out of the hat is not necessarily applauded unless it moves the project closer to the goals/milestones. Directed science feels like some independence is lost for the academic scientist who transitions to a company. While doing science in a company to develop products – consider scale and reliability as critical aspects of the product being designed or developed, not as afterthoughts.

For leaders in an academic lab there is more consensus building activities to make decisions, but in companies, the CTO often has to make decisions unilaterally if the project seems to be going of course. That shift in leadership style must be clear to the scientist who founds a startup as the accountability of the position requires that decisions are owned by the person in that role.

5. **Do we need a board of directors ?**

The board of directors usually include (1) the representatives of the largest shareholders (usually investors, founders), (2) the CEO and possibly other management (executive directors), and (3) independent directors. The directors primarily have a fiduciary duty to ALL the shareholders of the company and act on their behalf to oversee management. So yes, your startup will need to have a nominal board of directors.

For an early-stage company when the main activity is R&D, a one- or two-member board is adequate. Typically, a third outside director is added to ensure due process and that voting is not stalemated. A board of advisors is more useful to bring the support of important names in the field to add instant credibility or bring specific relationships to the young company. Board members representing investors or shareholders do not typically get equity or remuneration from the company. Independent board members may be granted between 0.25% - 2% equity, with no cliff (or 4 month cliff) and vesting over 4 years.

As the company crosses various financing rounds, more investors get involved and the board can grow from 3-5 through seed or series A and can get to 7 people when Series B/C rounds are done. A good securities lawyer's guidance should be sought to help create by-laws/operating agreement to appropriately structure board formation and terms.

Board members typically will get reimbursed for business related travel expenses. Companies also usually indemnify directors from liability in general and most directors will require company to have a directors and officers insurance policy for at least $1M in place (premiums may range from $3500-$6500/year).

6. **How to make boards and board meetings productive and useful to the company ?**

- Discuss and confirm the time commitment and availability of a director during the initial interview and discuss expectations on both sides

- Do assign roles to the board members such as compensation committee, personnel committee and assign strategic tasks to help with major initiatives (like M&A).

- Recruit independent board members with a view to how their background and network can help meet the next key value-adding milestones e.g. raising funding, strategic partnering, IPO, M&A etc. Board members should be asked specifically how they can contribute to the next upcoming goals.

- Prepare board members with sufficient level of detail before the board meetings and have structured meetings with agenda arranged so that most important strategic issues are presented at the beginning of the meeting, giving enough time for discussion.

- Board meetings should promote two-way dialogue – reporting from management team to board and gathering feedback from board members through topical discussions geared to raise input from board members.

- For a startup with no revenues, the remuneration of the directors should only be in equity

7. Corporate Documents Needed for Startup

- Articles of incorporation contain the authorized and outstanding share count, the terms of each class and/or series of capital stock and the baseline rights of all participating shareholders.

- By-laws list the formal rules and procedures for internal management of your startup, including election of directors, how to conduct board and shareholder meetings including notification periods, kinds of officers and descriptions of duties.

The above founding documents filed with secretary of state of incorporation will likely be amended after the first institutional financing as preferred shares and terms of those shares need to be added and other rights for preferred shareholders need to be recognized in by-laws.

Other key corporate documents that will be added after financing and kept in internal corporate records (do not need to be filed) include:

- Shareholder Purchase Agreement – terms and conditions, indemnities, warranties, price of shares sold, and other terms of agreement between company and investor.

- Shareholder Rights Agreement – signed by all shareholders and company that provides specifics around election of the board of directors, board powers and privileges, special shareholder approval rights that an investor group is given, etc.