What All Tech Start-Ups Need to Succeed

By Theodoros Evgeniou and Ludo Van der Heyden, INSEAD and Yann Lechelle, INSEAD MBA ’01J

Governance exists to help tech entrepreneurs prevent value destruction from day one.

Entrepreneurs are, by nature, outliers with a strong desire for autonomy and impact. They prefer learning by doing and turn failures into lessons for future victories. But while these qualities allow for innovation, disruption of industries and at times remarkable changes to society, they can also lead to disastrous failures – for themselves, their ventures and even us all.

This is due to one simple reason: entrepreneurship is more of an art than a science and nobody plays a perfect game. That is precisely why guardrails and guidance – two governance pillars – are essential to keep people and organisations in check and allow them to reach their full potential.

Unfortunately, entrepreneurs often misunderstand governance, and regularly neglect to properly manage and implement governance structures and habits, resulting in significant value destruction and lack of long-term sustainability. This is aptly illustrated in our video discussion below on maximising entrepreneurial potential.

Copyright © INSEAD 2023. All rights reserved. This article first appeared on INSEAD Knowledge: https://knowledge.insead.edu

Theranos is just one example of how poor governance can lead to disaster – including the **prison sentences** of its founder-entrepreneur and her partner. While this is an exceptional case of governance failure, it is regrettably not an exception. American tech entrepreneurs are characteristically negative about the virtues of governance. The ouster of Steve Jobs from Apple in 1985 after a power struggle with the board and CEO, and **Elon Musk's antics at Twitter** are just two examples that attest to this.

It doesn't have to be this way. Avoiding value destruction requires a fundamental change in how entrepreneurs view, commit to and practice governance. The purpose of good governance is to support entrepreneurs to create long-term value and ensure that start-ups don't hit major roadblocks on their journey. The world is losing too many innovative solutions and game-changing technologies for the wrong reasons.

Why tech entrepreneurs often fail and what's at stake

Tech entrepreneurs today must move at speed and scale much faster than usual, making it increasingly necessary to anticipate rapid change and potential chaos, rather than simply react to it. It is challenging for a venture to have transformative impact if it has an insufficiently prepared and poorly advised leader or team at the helm.

Tech entrepreneurs consider that their expertise sets them apart from other executives, including CEOs of more established firms. In many ways this is true. However, they often wrongly develop a false sense of power and authority as a result. They are extremely difficult to govern when they assume they know better – much like solo mountaineers attempting to summit Everest without oxygen tanks or capable sherpas to guide them. The sad reality is that most solo climbers do not survive. Many entrepreneurs do not either.

Tech entrepreneurs typically consider governance to be bureaucratic, a practice of large incumbent corporations – the very ones they wish to disrupt. Ironically, neglecting governance makes it easier for others, particularly investors and future acquirers, to gain control of the venture, alter its mission and even force founders out. Sometimes this surgery may be necessary, but often it is needless, too brutal, premature and unjust.

Copyright © INSEAD 2023. All rights reserved. This article first appeared on INSEAD Knowledge: https://knowledge.insead.edu

This is the critical mistake they make: Entrepreneurs are not business executives and start-up governance is not “corporate” governance. It is critical that entrepreneurs truly understand and value the multiple and nuanced aspects of start-up governance – a distinct breed that needs to be tailored to fit every stage of the start-up journey to success.

Beginning stage: Seeking expert help

In complex, fast-paced environments, tech entrepreneurs should seek external help from day one, including in governance. Governance in the early stages should not be a very formal affair. It should fit the style of the venture and of the founders. Trust is paramount, and the idea is for the founder or founding investor to find people willing to co-create and buy into the mission of the venture and infuse the project with the right governance philosophy from the very beginning.

Take for example the story of Bluetooth headset manufacturer SouthWing that experienced rapid growth in the mid-2000s but ultimately filed for liquidation in 2009. Before it all unravelled, founder Bart Huisken, with the help of a trusted mentor, recognised the need for governance that was neither cosmetic nor bureaucratic. His mentor urged him to establish a small, but real supervisory board to support the venture before he searched for financing. The start-up was on the right track, at least at this stage.

Governance is about conversations with the right people bringing their e xperience and wisdom to the table in support of the venture. In the early stages, it does not matter whether these are advisory or formal boards with legal responsibility. These boards are a way for founders to affiliate with experienced executives bringing competencies and talents that the venture and its founders may not have.

Middle stages: Navigating shifts in power, mission and governance

In the early stages of a start-up, angel investors provide support, typically without making demands. However, further along the journey, entrepreneurs often meet a “wall” – the search for significant financing that can truly allow their venture to take off. While waiting for the “big money”, Huisken began collecting funds from personal acquaintances and close associates. The chairman of the board, out of a mix of sympathy, conviction and duty, proved to be the most forthcoming.

Copyright © INSEAD 2023. All rights reserved. This article first appeared on INSEAD Knowledge: https://knowledge.insead.edu

As new investors came on board and investments increased exponentially, investors soon began to excessively pressure the management team. They insisted on supporting the venture by having board members take on executive responsibilities within the company – crossing the line between governance and execution, a typical red flag.

While roles and responsibilities need to be clear, the mission needs to cascade down from the owners to the board and executives. Alignment at all three levels – owners, board members and business leadership – is critical for value creation. Shifts in shareholding inevitably trigger changes in power, and hence mission, board membership and practice. Managing these transitions for value creation requires deft navigation.

Consider the case of the artificial intelligence voice platform Snips. The board stemming from the seed financing round was mostly “cosmetic”, and the shareholders expected major advancement from a B2C business model. Unfortunately, the model didn’t take off, leading some shareholders to request a fire sale. The company had to pivot to a B2B model and raise funding with entirely new investors. All along this journey, the new board proved unable to steer the company, resulting in near bankruptcy several times.

Good governance prepares and guides entrepreneurs through these transitions and ensures the mission is adequately transferred or transformed. It ensures that changes in leadership are driven by the needs of the business, and that founders that need to “transition out” are fairly taken care of. In this sense, governance and mission are intertwined – governance here is about setting, and possibly resetting, the direction of the company while navigating stormy waters.

Final stages: Thinking two boards ahead

By series B or C funding, initial founders and shareholders are no longer majority owners, and the mission has likely been repurposed to secure needed funding. This can fundamentally alter the spirit of the venture, particularly when new investors prioritise money over mission.

When value destruction occurs, dreams are shattered, and management is usually blamed. Poor management is both a symptom and consequence of poor governance. In private ventures, owners must ultimately take responsibility for poorly functioning boards. Establishing a strong (sounding)

Copyright © INSEAD 2023. All rights reserved. This article first appeared on INSEAD Knowledge: https://knowledge.insead.edu

board from the start is key. Moreover, owners are wise to think two boards ahead rather than be stuck with a board reflecting the past. Anticipation is an indispensable requirement in fast-moving tech industries.

As the company and its governance co-evolve, it is important to confront the reality that it is much simpler to find a good board member than a great CEO. It is easy to underestimate how precious a great CEO is, and how an average one can be problematic. The choice between firing a CEO or a board member should be an easy one.

Returning to the case of SouthWing, conflicts emerged between the new investors and the original board members. These conflicts trickled down within management, creating issues of authority for CEO Huisken. The well-intentioned new shareholders began steering the company in their desired direction, downgrading the CEO and eventually pressuring Huisken to retire from the position. The newly hired management team underperformed, leading the company to experience a significant reduction in revenue, while having considerably increased its burn rate. This marked the beginning of the end for SouthWing.

One final step that must be considered is the pre-IPO stage. No founder can match the experience of a few board members that have gone through this phase. Again, good boards prove their effectiveness by managing this transition without value destruction. While start-up governance is not the same as that of public firms in the initial stages, it evolves that way as the start-up moves beyond the IPO stage.

The inevitable nature of start-ups is that as they progress, they invariably move from one predicament to the next. An experienced, effective board greatly helps navigate these stormy seas.Governance needs to evolve during this journey, along with the company and its leadership. A poor board is worse than no board at all as it accelerates a start-up's demise. Formal governance too early on slows the journey down. By establishing appropriate governance from the outset, tech entrepreneurs greatly increase the chances of bringing their intended venture to its desired destination. In this way, good governance, just like good management, contributes to the betterment of the world.

Find article at

https://knowledge.insead.edu/entrepreneurship/what-all-tech-start-ups-need-succeed

Copyright © INSEAD 2023. All rights reserved. This article first appeared on INSEAD Knowledge: https://knowledge.insead.edu

About the author(s)

Theodoros Evgeniou is a Professor of Decision Sciences and Technology Management at INSEAD. He has been working on machine learning and AI for more than 25 years.

Ludo Van der Heyden is the INSEAD Chaired Professor of Corporate Governance and Emeritus Professor of Technology and Operations Management. He is the founder of the INSEAD Corporate Governance Centre. Professor Van der Heyden is also Chairman of a software company in natural resource estimation and is a regular adviser to boards and leadership teams across the world.

Yann Lechelle is an entrepreneur and tech executive and holds an MBA from INSEAD. He was CEO at Scaleway and has founded, grown and exited a total of five tech start-ups.

About the series

Corporate Governance

Established in 2010, the INSEAD Corporate Governance Centre (ICGC) has been actively engaged in making a distinctive contribution to the knowledge and practice of corporate governance. Its vision is to be the driving force in a vibrant intellectual community that contributes to academic and real-world impact in corporate governance globally.

The ICGC harnesses faculty expertise across multiple disciplines to teach and research on the challenges of boards of directors in an international context. The centre also fosters global dialogue on governance issues, with the ultimate goal of developing high-performing boards. Through its educational portfolio and advocacy, the ICGC seeks to build greater trust among the public and stakeholder communities, so that the businesses of today become a strong force for good for the economy, society and the environment.

Find out more about ICGC

Copyright © INSEAD 2023. All rights reserved. This article first appeared on INSEAD Knowledge: https://knowledge.insead.edu