Should You Allow Board Observers on Your Startup Board?

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A board observer is somebody who attends your board meeting but doesn’t have a voting right. There are also certain points in a board meeting where you can ask the board observers to step out of the room unless they’ve negotiated specific rights that preclude this.

Why do board observers exist? There are actually several type and I’m going to make the case that if you can avoid board observers you generally should and when you do have them you should be thoughtful about how you manage them.

Note: This is part of a series on Startup Boards. The full lists of posts is on the link.

Types of Board Observers

1. Venture Capital “Plus 1's”—Many VC firms ask for a +1 observer and there is a reason for this. Often partners like to bring along an analyst or associate both as a way to help train younger staff (it’s an apprentice business) and also to have somebody to follow up on action items. This can be practical for both parties if this is a senior partner already sitting on 10–12 boards.

In the first instance I recommend trying to negotiate that this not be a legal right but make a verbal agreement that it isn’t a problem for you. I figure if it doesn’t need to be legal why make it so. If they insist—or even if they don’t—I like to have an agreement that the VC +1 is a “silent observer” meaning they are truly there to observe and not participate unless specifically called on by management or another board member.

This isn’t anything against the +1, in fact they often have more detailed knowledge than the partner because they’ve had more time between meetings to focus on key company details. The reason for silence is that a board meeting consists mostly of people weighing in with opinions and discussion topics. On a board with 5 members plus a CFO plus a legal representative plus 1–2 management—every voice has the ability to sway a conversation and the tenor of the meeting.

To be clear about one thing—almost nothing controversial is EVER voted on at a startup board meeting. Most votes are for administrative tasks such as stock options, 409a valuations, meeting minute approvals, compensation increases, etc. So the value of a person in the room is the value of their speaking and ability either to persuade others or to be disruptive when you’re seeking consensus.

So my golden rule is you should try to get legal or verbal agreement that board observers are silent unless called on and set the tenor as such or you’ll find that your 5-person board is really an 8-person “board.” This is true whatever the reason the board observer is present.

2. Strategic Investors—This is the second most common reason you may have board observers. In some instances strategic investors prefer not to take board seats as it might be their corporate policy. In other situations they might be writing smaller checks but want to be present at board meetings for strategic rationale. There are also times where strategic investors only get a board observer seat because YOU

requested it due to the sensitive nature of working with somebody in the industry.

There are many corporate investors who are more financial investors that typical strategic ones. Groups like Comcast, Intel, Salesforce, Microsoft and Qualcomm come to mind although I think you should push for a legal agreement that they are willing to leave the room when anything sensitive to working with them or their competitors is raised.

As a general rule I prefer that founders avoid strategic investors in the A and B round of financing when the company is more nascent and include strategics in later rounds when you can invite multiple ones at the same round and you cannot be seen as being in any one particular strategic investor’s pockets.

3. Minority Shareholders—Sometimes a group comes into a late round with a smallish check relative to the round size but request a board observer seat. I would treat this like any other observer discussion—avoid a legal requirement if you can. Frankly there are just times where for one reason or the other you decide it’s better to have a small investor in a late round vs. not and a board observer can be a safe way to avoid a legal board seat so it can be a negotiation technique for you to offer them an observer seat.

4. Certain Venture Firms that Want Board Rights but not Board Obligations—Finally, there are a few firms I’ve noticed these days that ask for observer rights that they treat as though they are full board seats. They see this as a way of having board influence without any of the legal responsibilities and liabilities. I personally think you should avoid this at all costs—even though I know I’m going to piss off a few friends by writing this. My view? Either they’re committed and they should take a board seat with full rights and responsibilities or they should trust others who are willing to do the actual board work represent them. Flush them out. If they’re not willing to be a full board member may they aren’t worth having around the table. I just don’t believe in free passes and as somebody who takes his legal obligations very seriously I don’t see a reason others should skate. If they do persist in this model perhaps you seek the silent board observer agreement.

And finally, a word about observers and managing admin

Ask anybody who has responsibilities for scheduling board meetings and board calls and they will tell you how difficult it is to agree dates and times with a variety of investors—especially when some or many have to travel.

The rule should be clear—you first prioritize the schedules of your legal board members and get a date on the books and then make “best efforts” to pick a date & time that also works for your board observers. If they can’t make it then they can send somebody else to observe for them (or perhaps you can record the meeting for them).

Trust me—life is complicated enough than having to play Tetris with another three calendars to get a board date agreed and nothing is more irritating than a board date that gets pushed out because a 2% board observer couldn’t make a date 30 days earlier.

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