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NASCENT GOVERNANCE: THE IMPACT OF ENTREPRENEURIAL FINANCE ON BOARD FORMATION AND ROLES

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ABSTRACT

This research is an attempt to make progress in the understanding of the process of board formation and its impact on the functions performed by the board in young entrepreneurial ventures. We study the link between board members' characteristics and the effective accomplishment of monitoring and resource provision functions. Expanding earlier research we argue that the identity of external financiers matters in configuring the board and designing its working mode and roles. This is because different investors (1) may be endowed with different skills and knowledge, and (2) their social identities influence the motivation to accomplish different roles. We present a conceptual framework of the process of board formation in entrepreneurial firms and confront it with an in-depth longitudinal case study of a young venture that has received funding from business angels and venture capitalists. We show that board composition and routines are co-constructed by different (but not all) salient stakeholders who were involved in the first input of external capital. The intended and actual role of the board members depends on their specific capabilities and financial stakes and on processes of social identification. The observation of evolving board routines shows that certain members participate in two parallel processes of interaction with the entrepreneurs. Formal board meetings essentially serve the purpose of regular monitoring, whereas certain board members contribute to resource provision in parallel informal interactions, when they strongly identify themselves with entrepreneurs.

INTRODUCTION

Traditional research on boards of directors has taken a special interest in boards of large established corporations featuring a strong separation of ownership and control (Fama and Jensen 1983). Agency theory has been the dominant theoretical frame to understand boards' functions and effectiveness (Daily *et al.* 2003), where efficient monitoring achieved through a majority of independent outside directors is supposed to be the principal source of superior performance as related to corporate governance. Empirical evidence on the subject, however, is highly inconclusive (Bhagat and Black 1999). In an effort to overcome the limitations of traditional board research, it has been acknowledged that boards may accomplish multiple roles, reaching from monitoring to the provision of different types of resources (e.g. cognitive, relational, legitimacy) (Zahra and Pearce 1989). Hence, a better understanding of a board's actual functioning and process has been called for (Pye and Pettigrew 2005). In fact, the link between board members' characteristics in terms of particular interests/incentives, demographics, knowledge and skills and the effective accomplishment of such functions as monitoring and resource provision is not immediate, but most likely depends on the way the board is initially configured and develops work routines through directors' specific interaction.

The way a board works, the functions it may fulfill and, parting, its impact on performance can be supposed to depend on the specific circumstances of its formation and on the particular actors who contribute to its configuration and effective functioning. Interestingly, though, little attention has so far been given to the process of early board formation. One notable exception is work by Lynall *et al.* (2003), who suggest that a board's composition and working style is likely to be influenced by the lifecycle-stage of its formation and the action of powerful stakeholders when the board is actually formed for the first time.

In the present contribution, we are specifically interested in the formation and early functions of the board of high growth entrepreneurial ventures when crossing an organizational threshold as they raise significant amounts of outside equity. Boards are actually formed through the action of different salient stakeholders, and the entrepreneur-CEO as well as the contributors of venture finance can be regarded as the central protagonists in the process of board formation (Lynall *et al.* 2003). Our work brings together two distinct streams of research: entrepreneurial finance and corporate governance. In entrepreneurial finance, the identity of external financiers matters. Two types of actors typically specialize in the provision of external equity finance for entrepreneurial threshold firms: business angels and professional venture funds. They have been shown to play distinctive roles (e.g. Bonnet and Wirtz 2012), due to their specific motivation and cognitive features. Recent progress in research on corporate governance tends to emphasize that the relevance of different theoretical approaches concerning board roles likely depends on firms' life-cycle stages (Filatochev and Wright 2005; Lynall *et al.* 2003; Zahra and Filatochev 2004; Zhang *et al.* 2011). They do not, however, explore the process of the formation of boards as the result of the action of specific stakeholders at relatively early stages in a venture's life cycle.

We argue that, beyond the contingency of the life cycle, the precise identity of external financiers matters in configuring the board of directors and understanding its working mode. This is because different investors (1) may be endowed with different skills and knowledge, and (2) their social identity potentially influences the intrinsic motivation to accomplish different board roles (Hillman *et al.* 2008). In other words, in a multiple-investor setting, for a specific investor, say business angel A, to be willing to join the board and be able to play a specific role (counsel, monitoring...) not only certain capabilities and skills (strategic knowledge, entrepreneurial capabilities, information acquisition skills...) and an economic incentive are required, but his social identity can also be supposed to have an impact on the actual role he chooses to play.

The present research is an attempt to make some progress in our understanding of the process of board formation and its impact on the functions performed by the board and its members, both individually and collectively, in fast growing entrepreneurial ventures. Specifically, we try to answer the question of why certain investors sit on the board or push other actors to do so and what functions they intend to and, eventually, do perform in the exercise of their board-membership individually and with others.

The remainder of this article is structured as follows. Building on the combined literature of entrepreneurial finance and corporate governance, we first present a conceptual framework of the process of board formation in fast growing entrepreneurial threshold firms. We then confront this framework with an in-depth case study of a fast growing young technology venture that has received funding from several business angels and venture capitalists. Section 2 gives a description of our method, section 3 presents the case, and section 4 indicates the principal results.

ENTREPRENEURIAL FINANCE AND THE NASCENT BOARD: CONCEPTUAL FRAMEWORK AND LITERATURE REVIEW

Conventional research on boards of directors in the tradition of agency theory (Fama and Jensen 1983) may lead to the impression that the board is initially installed to accomplish a single function, namely ensure effective monitoring of the CEO. More recent approaches to corporate governance, especially those working from a cognitive and behavioral perspective (Charreaux and Wirtz 2006; Forbes and Milliken 1999; van Ees *et al.* 2009; Wirtz 2011) have questioned the exclusive focus on a board's monitoring function. Different roles of the board have thus been identified (Zahra and Pearce 1989). To simplify, we may retain two main roles: monitoring and resource provision (especially of a cognitive and social nature through counsel, mentoring, establishing legitimacy, providing relationships, sustaining organizational learning).

The question then arises, however, of what determines the exercise of different board-roles. Casual observation suggests that certain board roles are more salient than others in specific companies, and one possible explanation that has been given makes economic context, especially in terms of a firm's life-cycle stage, the critical determinant. Hence, Wirtz (2011) argues that due to their initial lack of the specific managerial capabilities required to master the dynamics of hyper-growth, fast growing entrepreneurial threshold firms have a strong incentive to use governance mechanisms as a cognitive lever, helping acquire and develop specific cognitive skills and capabilities, rather than making them a pure monitoring device. It must however be noted that it is not because threshold firms may feel a particularly strong need to acquire and develop such knowledge and skills that their boards are necessarily in a position to provide such resources. We argue that the board's actual accomplishment of one or several of its potential roles (monitoring, resource provision) depends on the precise identity of its members and, hence, on the process of its formation and the work routines it develops as it goes along. After all, many young ventures go bankrupt because they are not in a position to acquire or develop the required skills and resources to overcome the liability of newness (Stinchcombe 1965). Others are successful, but the board is not the only mechanism which can be used to manage the particular challenges of fast growing entrepreneurial threshold firms (Wirtz 2011).

We propose a conceptual framework (figure 1), where the process of initial board formation is shown to be shaped not only by economic context but also by the specific identity of the participating stakeholders (external investors and entrepreneurs being the most salient in threshold firms), depending on their personal characteristics (knowledge and skills), economic motivation (financial stake) and intrinsic motivation (identity). Because life-cycle stages should not be seen as having deterministic consequences, the interaction of the specific actors forming the board is central to our understanding of the degree to which the board and its members eventually activate their different possible roles. We argue that, at the very early stage of board formation, individual salient stakeholders' (especially investors') intrinsic motivation as explained by a phenomenon of social identification (Hillman *et al.* 2008) may be the critical determinant in explaining who initially joins the board and what role he or she intends to play. The following sub-sections develop each of the framework's dimensions in more detail, building on the combined research on entrepreneurial finance and governance.

Potential board roles: what is the board set up to do?

A major systematic assessment of different possible board roles as identified in the literature was proposed by Zahra and Pearce (1989). They identified three different roles or functions potentially accomplished by corporate boards, namely control, service and strategy. Later work

has added a strong cognitive perspective (Forbes and Milliken 1999) and suggests a combination of the service and strategy functions in a single category, for the enhancement of strategic knowledge through learning on the board level can be considered as the provision of a dynamic cognitive resource. Hence we end up with two possible functions: control and service. “*The board's control task refers to its legal duty to monitor management on behalf of the firm's shareholders (...) The board's service task refers to its potential to provide advice and counsel to the CEO and other top managers and to participate actively in the formulation of strategy*” (Forbes and Milliken 1999, p. 492). The most recent research on board process in threshold ventures essentially takes up the same basic categories (Zhang *et al.* 2011). Consequently, we distinguish in our theoretical framework two generic board roles: monitoring (or control) and resource provision in its largest sense (counsel, mentoring, networking, legitimacy, learning). The question is what weight is given to each by the constituting members of the board as it is first set up, and for which reasons?

Economic contingencies of the nascent board: life-cycle stage and growth dynamics

Specific economic contingencies, such as a firm's lifecycle stage and growth, are one possible answer. The entrepreneurship literature has identified the liability of newness (Stinchcombe 1965) as a central challenge for young growing ventures. This concept means that young firms have to overcome a lack of various kinds of resources in order to survive and become established in the market. In particular, roles must be learned and (organizational, functional and entrepreneurial) and capabilities acquired (Landström *et al.* 2012). The necessity to acquire such capabilities and other cognitive and social resources (such as external network ties and legitimacy) may be considered to be especially strong in fast growing threshold ventures, because crossing the threshold means an increase in organizational complexity which, in fast growing firms, may be quasi-instantaneous. This does not leave the incumbent entrepreneurial top management team with sufficient time to develop the requisite skills by themselves. In such a situation, existing research suggests that the board of directors is one possible provider of the necessary cognitive and social resources (Daily and Dalton 1992, Hambrick and Crozier 1985, Zahra and Filatotchev 2004).

Empirical research on board process confirms that, in certain young high-technology ventures, the board does actually accomplish a strong service function. According to Zhang *et al.* (2011), the tension between roles (monitoring *vs.* resource provision) is resolved in favor of resource provision in actual board practice, although boards have the formal characteristics required to be good monitors. Zhang *et al.* lack however a compelling theoretical explanation of why the board of a technological threshold venture should *always* be set up and function as a resource provider. In theory, other governance mechanisms can substitute for the role of valuable resource providers, to fill the competence gap of young fast growing ventures (Wirtz 2011). It thus seems reasonable to turn to an examination of the individual motivations of threshold ventures' salient stakeholders and constituting board members to better understand in what spirit the board is set up.

Entrepreneurial finance: characteristics of business angels and venture capitalists

According to Lynall *et al.* (2003, p. 421-422), for the threshold firm which is outgrowing its initial founding stage, “*at the time of board formation, (...) two stakeholders (i.e., CEO and external financiers) can be considered the most salient to the organization and, thus, the most likely to influence board composition. (...) Although other stakeholders might influence board composition, the urgency and salience of the CEO's and external financiers' claims on the organization identify them as the most important vis-à-vis board composition*”.

The two most frequently encountered types of external financiers at that particular development stage are business angels (BAs) and venture capitalists (VCs). BAs are predominantly actual or former entrepreneurs who invest their own money (Morrissette 2007), whereas VCs are finance professionals who manage investors' money. Therefore BAs' knowledge base and cognitive process are close to entrepreneurs'. Due to their experience they generally have good knowledge of a specific technology, industrial sector or market, and they express a preference for investing in industries they know (Wright *et al.* 1998). VCs, although some of them may have technological or industrial experience or expertise, often have a more generalist background. BAs' investment objectives also appear to be closer to entrepreneurs' than those of VCs. BAs want to make money but they grant less importance than VCs to precise IRR and exit timing objectives, and they appear to have diverse non financial goals such as challenge, fun, helping to start a new company, that are as (or more) important for them as (than) financial goals (Farrel 1998; Kelly and Hay 2003; Morrissette 2007). VCs set their objectives in financial terms only and need to control the exit as they are committed to create value for their fund providers in a limited time frame. These differences lead to the following questions regarding board formation: In fast growing threshold ventures, where BAs and VCs are the most salient stakeholders, can we assume that they all typically intend to join the nascent board? For those who do, what primary function do they wish to fulfill in their role as a board member?

Social identity and intrinsic motivation of board members

According to Hambrick *et al.* (2008, p. 384), understanding the directors' motivations to join the board is key "*in comprehending board processes or effectiveness.*" Concerning BAs and VCs the answer could appear to be rather straightforward, since a board seat may help control the potential risks affecting the individual investor's financial stakes. But still, in ventures with multiple outside investors (several BAs and VCs at the same time), not all of them necessarily wish to join the board, even if they possess the necessary knowledge and skills. For those who do wish to participate, the question remains of how they conceive their principal role as directors, as the economic interests related to financial stake potentially benefit from both, monitoring (value capture) and resource provision (value creation). Since BAs and VCs are not homogeneous populations, they do not necessarily identify with the same board roles to the same extent. In fact, the external investors' perception of and identification with specific board roles, which can be supposed to shape the way the newly created board ultimately functions, is likely to be related to their individual and social identities as construed in identity theory (Ashforth and Mael 1989; Hillman *et al.* 2008).

Hillman *et al.* (2008) propose a model linking directors' identities and identification to the board roles they fulfill. Each individual holds multiple personal (e.g. being a father, brother, ...) and social (e.g. being a professor, a CEO ...) identities, and the strength of identification with each one in a particular context (e.g. on a board of directors) explains his or her preference for certain types of behavior/engagement. For example, an external board member who has also an important experience as former or actual CEO may be supposed to strongly identify with the CEO of the firm on whose board he serves. This is likely to lead to an intrinsic motivation to favor the resource provision role of the board over the monitoring function. According to Hillman *et al.* (2008), there are five contextually relevant identities for directors who serve on boards: director, CEO (entrepreneur), shareholder, organizational identity and stakeholder. For young threshold ventures which are still in a process of becoming, it is however reasonable to suppose that organizational identity is not yet stabilized and is thus likely to have low relevance in the specific context of the present study. Probably, a certain industrial identity (identification with a certain industry or profession) may be more relevant in this situation.

The identity and motivation of business angels and venture capitalists

We transpose the general frame of Hillman *et al.* to the specific case of the entrepreneurial threshold firm, where BAs and professional VCs contribute to growth as salient stakeholders. We expect that BAs typically identify more strongly with the entrepreneur-CEO than VCs, particularly when they have founded or managed a new venture themselves. This should create a strong motivation to provide assistance, counsel and other cognitive resources. In addition, the fact that angels' investment objectives are not merely financial may also lead them to identify with the entrepreneurs and to adopt a resource provision role. BAs may also identify with specific industries in which they have a significant previous experience. This can provoke an additional motivation to provide resources to the young venture, particularly when it is involved in one of these industries. Another likely identification of BAs is "shareholder", as they are investors in the young venture, which may conduct them to monitor management in addition to provide resources. We may expect this identification to be stronger when their financial stake in the venture is higher.

VCs' main investment objective is to provide high financial returns to their investors, and they have strong economic incentives to do so. We therefore expect them to identify themselves mainly with shareholders. This may lead to both monitoring and resource provision roles, as these two roles can contribute to foster growth and create economic value. The relative importance granted to monitoring vs. resource provision is probably influenced by institutional factors (large and experienced VC organizations are expected to develop more structured and formalized rules to monitor portfolio companies), individual factors (i.e. personal characteristics and background) and economic contingencies. Another possible identification of VCs is "industry", in the case they have a significant previous investment experience in a given sector. However this identification is expected to be generally lower for VCs than for BAs.

METHOD

Case selection and data collection

To be able to closely observe the process of board formation, we have chosen to do longitudinal case research with real-time observation, as suggested by Zhang *et al.* (2011). One central concept of our conceptual frame being identity, we have selected a case with multiple investors of various identities. The company (EBV) is a young and fast growing venture which completed its first financing round with four BAs and three VC funds investing simultaneously. An interesting feature of the case is that the external investors are very diverse with regard to their status, previous experience, knowledge and skills, as well as financial stakes in the venture, therefore offering a wide array of potential identities when serving on the board of directors (table 1).

We performed three successive sets of interviews with the case's actors between the end of 2009 (i.e. six months before the financing round took place) and the fall of 2011 (table 1). Such real-time following of the case is likely to reduce bias related to loss of memory and obtain more reliable qualitative data concerning an unfolding process. The interviews were semi-directive. They lasted about one hour and a half on average, were tape recorded and transcribed. In complement to the interviews we obtained detailed profiles for most investors from a search on the internet. The first interviews were made with the two co-founders and provided initial information on the venture and on the entrepreneurs, as well as on their expectations *vis à vis* the potential investors and the future governance of the company. The second set of interviews was conducted

in June/July 2010, just after the financing round and around the time of the first board meeting, with the co-founders, two business angels and two VCs. We were able to gather valuable information on the investors' characteristics, on their intentions concerning the future governance of the venture, and on the context and the dynamics of the initial board formation. The third set of interviews was performed between July and December 2011 (i.e. 12 to 18 months following the board formation) with the founders and four of the five external board members in order to get information on how the board was actually working and performing its roles.

Coding scheme

The interviews were coded independently by two of the authors, one of whom not having attended the interviews. Coding was done using NVivo software, according to a coding scheme containing the major concepts of our conceptual framework. The inter-coder agreement rates are high, with an average for all nodes of 94.1 % (minimum 85.0%, maximum 98.8%). The coding scheme and the number of references coded per item and per actor are indicated in table 2.

THE CASE

In this section we present a the venture studied, the external investors, the process of board formation and the initial board tasks and roles.

A brief case history

EBV is a French venture created in 2006 by two first-time entrepreneurs. Their primary competency is technological, with a strong engineering background. The prior experience of one of the founders (Entrepreneur 1, the CEO) at a major high-tech firm has led him to develop ideas about the existence of a market for a new technological application in the design of electronic components. The prototype of the first product, an application aiming at filling the need previously identified by entrepreneur 1, was then developed, tested, and sold to the first (big industrial) clients in 2008. Sales grew at a three-digit rate between 2008 and 2009. This early stage growth phase did not require external investors, as the founders used bootstrapping and received subsidies from the government and from a local entrepreneurs' association. However, in 2010, the venture was at a stage where it needed to intensify commercial efforts and to expand the client-base to satisfy its ambition to become a standard reference for the industry at an international level. As most customers are based outside Europe, this commercial development and the necessity of sustaining a strong effort in research and development required new funding.

External investors

After various contacts with financial investors, the encounter with a business angel (Angel 1) has proved to be particularly conclusive. This investor is a former scientist and entrepreneur who successfully founded, managed and sold his own venture – a software editor – and acquired a strong entrepreneurial experience in the process. Angel 1 and entrepreneur 1 have established a close and confident relationship, the former acting as a mentor to the latter even before he invested in the company. Angel 1 is strongly convinced of the quality of EBV's team and project. The strength of his persuasion, as well as his local credibility and reputation, were key in attracting the group of investors who took part in the financing round.

The other external investors are three more BAs and three VC funds. Angel 2 is an US-based French who was formerly a co-founder of the Angel-1-venture. He has been responsible for the

development of the latter's American business and is now the CEO for America of a French software company. Angel 3 is also a successful former entrepreneur, although from a totally different field. Having a doctor's degree in pharmacy, and after several years of work experience in the field, he created a biotech venture which he was able to sell in 2007 to an international competitor. He then set up a family venture fund which made several investments in the life sciences sector. Angel 4 is a business-school teacher and works as a consultant in the area of entrepreneurship and finance. Capitalist 1 is a local venture capital firm which was created at the initiative of regional public bodies. Its CEO, who is in charge of the EBV investment, is a former business-school teacher. This relatively small VC firm is specialized in investing in early-stage innovative start-ups based in the region. Capitalist 1 was informed (and convinced) of the opportunity to invest in EBV by angel1, who is a member of his investment committee. He then became the leading actor in forming the investor group, inviting to the deal angels 3 and 4 as well as capitalists 2 and 3. Capitalist 2 is a large French independent venture capital firm. The manager in charge of the EBV investment has a French business school degree and joined the firm in 2002. He has a strong investment experience in the IT industry. Capitalist 3 is the private-equity subsidiary of a regional French deposit bank.

Board formation

Three investors (capitalist 1, capitalist 2 and angel 3) act as the main negotiators of the deal with the entrepreneurs and play a key role in designing the post-investment governance structure. These investors require that the company be managed by a CEO (Entrepreneur 1) and controlled by a board representing the major shareholders as well as providing a mix of complementary skills. They join the board alongside angel 2 and one independent director (table 1). The independent director (ID) is not an investor in EBV. He is a serial entrepreneur, claiming to have founded and sold fifteen companies in high technology. He has personal ties with the founders and is the former CEO of a successful venture financed by capitalist 2.

With respect to actor characteristics, the above descriptions indicate a certain degree of heterogeneity in personal trajectories (formal education, professional work experience), in knowledge and skills (industry specific, financial, entrepreneurial know-how...), as well as in institutional position as an investor (BA, VC). This may lead to specific expectations concerning the venture's governance and the role of the board, as well as to diverse levels of identification by the actors with potential director roles. Certain expectations concerning the governance process appear even before the financing round is actually performed and the board formally established. Entrepreneur 1 and 2 are willing to attract angel investors because they may provide them with advice and counsel on issues for which they lack the requisite experience, such as the venture's international development and future exit. They are mostly concerned with the resource provision role of the board. On the investors' side, Angel 1, although having played a key role during the first contacts in helping the entrepreneurs to convince the investors of the strong potential value inherent in the project, is practically not involved in the formal negotiations concerning the deal, and decides not to participate in the board process. Angel 2, angel 4 and capitalist 3 mostly act as followers in the negotiations and their input concerning board formation seems very limited.

Initial board tasks and roles

The main initial task of the board is the provision of information on the venture's activity and progress by the two founders to the external members. In fact, during our observation period, EBV is progressing as planned and follows the strategy initially formulated by the co-founders. Therefore no need to discuss key strategic issues is felt. However the board works on some

important implementation issues for which the experience and knowledge of its members can be used: the setting-up of an EBV subsidiary in the US and the choice of its manager (given the importance of the US market, entrepreneur 1 eventually moves to the US in August 2011 to run operations there, while remaining CEO), and the design of a stock option plan for EBV employees. Importantly, board tasks are not performed during formal meetings only. Entrepreneur 1 has frequent informal contacts with angel 2 and with the independent director. He also continues to exchange ideas and information with Angel 1, although the latter is not a board member.

A specialisation of external board members rapidly emerges with regard to their roles. Angel 2 is mostly concerned with providing practical advice regarding the US market and the creation of the US branch. ID is also focused on resource provision. Thanks to his background as serial entrepreneur in businesses close to EBV's, he is able to share his experience with entrepreneur 1, acting as an advisor and sounding board. The three other board members (Angel 3, Capitalists 1 and 2) are mostly involved in monitoring. They contribute to the initial work routines of the board. They also provide advice in areas in which they have a specific experience or expertise, such as the design of the employees' stock-options plan as well as on legal and financial management issues regarding the creation of the US branch.

RESULTS

The number of references coded per actor for each dimension of the model is indicated in table 2.

Board formation is strongly influenced by the characteristics of salient stakeholders

We first observe that specific salient stakeholders are leading the board formation process. The leading role is played by capitalist 1. Once convinced of the interest of the EBV deal, he becomes the major actor in forming the investor group and, at a second stage, the board of directors. The other salient stakeholders in this process are angel 1, who introduces angel 2 to the deal and to the board, and entrepreneur 1, who proposes that ID joins the board. As expected, all actors of the case, although being potential board members, do not join the board. In fact, board membership is mainly influenced by three factors: identification, knowledge/capabilities and, to a lesser extent, interests/financial stakes.

The three investors who have the strongest identification with the "shareholder" status become board members: angel 3 is a very successful entrepreneur who set up a family VC fund and whose main activity is presently to invest in young ventures; capitalists 1 and 2 are professional VCs who frequently act as lead investors. All three are also the main actors in the pre-investment negotiations with the co-founders. On the contrary, angel 1 decides not to participate in the board, although his experience, reputation and early role in funding would allow him to do so. A successful entrepreneur, his main identification is with "industry" and with the "entrepreneur" status. He does not consider himself as a financier, and his main motivation as business angel is to help young entrepreneurs to succeed, rather than to make money (*"I was helped a lot in my career by state funded grants and subsidies. It seems rather natural that I help in return"*.) However, although not being a board member, angel 1 continues to provide resources to EBV by mentoring entrepreneur 1 through informal conversations. In addition, when angel 1 introduces angel 2 to the deal, it seems that it is both for the latter's potential ability to provide resources to the venture (as a software industry specialist and a US based entrepreneur) and because he is a close business partner who may act as a kind of *de facto* representative.

Possessing the knowledge and capabilities that offer a strong potential contribution in the post-investment phase are another important factor for becoming a board member. Capitalist 1 insists on the fact that he considers EBV's board as a "nice" board because of the complementary skills it gathers "...with two industry guys, one being a shareholder and living in the US (Angel 2) and the other a sector specialist (ID); two VCs who have good industry knowledge (N.B.: capitalists 1 and 2, who made previous investments in the sector) (...) and a successful entrepreneur who managed a startup and did a very, very nice exit (angel 3)." On the contrary, angel 4, who does not have a significant entrepreneurial experience and specific industry expertise, is not offered to join the board. Nor is capitalist 3, who acted as a follower since he was brought to the deal by capitalist 1, in spite of the fact that his financial stake in the deal is similar to capitalist 2.

Financial interests are not absent as a determinant of board formation. Whereas board membership was strongly influenced by capitalist 1 for the investor side, ID's appointment as an independent director is proposed by entrepreneur 1. In addition to ID's potential contribution to venture success, this choice is viewed by entrepreneur 1 as a means to protect the entrepreneurs' interests in case a conflict would arise with the financial investors. Entrepreneur 1 and ID have close personal ties; he trusts him and views his membership as a way to equilibrate the balance of power between investors and founders. Entrepreneur 1 had the project to hire a second independent director on the board, but this was refused by the financial investors. Entrepreneur 1: *"For me, bringing (a second independent director) was not necessarily linked to the provision of resources, but to have another vote on the board. Today the majority of the board is on the investors' side. We brought ID in. I said to myself that if we wanted to rebalance the power in our favor, it would be good to bring in another member."*

Board routines: formal and informal governance processes

The formation of board routines is influenced by members' individual characteristics. On the investor side, capitalists 1 and 2 and angel 3, who strongly identify with "shareholder" (and whose board monitoring roles are important) are the major contributors. On the founders' side, entrepreneur 1, the CEO, plays the main role. Formal board meetings are held every three months. They are mostly dedicated to reporting by entrepreneurs to the board (entrepreneur 2 participates to the meetings although not being formally a member). Specific strategic and organizational issues are also discussed. Additional meetings are held when needed, as was the case to discuss the implementation of the stock-option plan for EBV employees.

The initial reporting format is proposed by entrepreneur 1. Minor adaptations asked for by the external members are progressively put in place. Minutes and pre-reads, which were absent during the very first meetings, are also regularly sent after a request by angel 3. This process is eased by the experience and capabilities of entrepreneurs 1 and 2. They were previously working in large industrial companies and were consequently used to reporting requirements. They also have an open and professional behavior, and consider the investors' requests as positive constraints, which contribute to the efficiency of the board's collective work. As expressed by entrepreneur 1: *"(these routines) may look dull and are not always put in place; the fact that (the investors) impose this rigor makes us more efficient"*.

The two other external board members, angel 2 and ID, are not involved in the setting up of formal board routines. This can be explained by the fact that they identify themselves with "entrepreneurs" much more than with "shareholders", and therefore do not consider their primary role in organizing the way the board works, nor in monitoring management, but rather in providing advice and support. A striking feature of the case is that resource provision by angel 2

and ID is largely made outside formal board meetings. In fact two parallel governance processes emerge since board formation: a formal one and an informal one, and the respective involvement of board members in these processes depends on their social identification:

- Informal governance: angel 2 and ID provide resources to entrepreneur 1 mostly on an informal basis, through one to one phone calls and meetings; this informal interaction is particularly frequent between ID and entrepreneur 1, as they have close personal ties and ID has excellent industry knowledge. ID says: *“With (entrepreneur 1) it is different, because he is a pal. Each time I can, we meet (...). We speak on Skype once a week (...). We speak about the business: «where do you stand? What do you do?”*
- Formal governance: capitalists 1 and 2 and angel 3, who identify strongly with “shareholders” mostly view the board as a monitoring device; they set up the formal board routines (with entrepreneur 1) and most of their contacts with the entrepreneurs materialize during formal meetings.

Board roles are influenced by member’s capabilities and identification

The board of EBV hence plays both monitoring and resource provision roles. Each board member’s contribution is influenced by individual knowledge/capabilities and social identification. In fact, a certain degree of specialization appears within the board members.

Capitalists 1 and 2, with angel 3, are board members mostly acting as monitors. They consider that the main function of board meetings is to provide information on the venture’s operations and performance. As capitalist 1 states *“above all, we are here to learn, to understand what is going on; so generally we don’t have a lot to say, unless on the issues on which we have some competencies”*. They mostly listen to the entrepreneurs’ presentations, sometimes challenge them. However, they also provide resources, mostly by bringing advice on issues on which they have an expertise as investors, such as the setting up of the stock options plan.

Angel 3 is a hybrid character. A former successful entrepreneur and a wealthy business angel, he has multiple identification with entrepreneur and shareholder identities, but not at all with EBV’s industry. He features strong contributions both to monitoring and to resource provision. He is very good at spotting the key issues and at challenging the entrepreneurs. Capitalist 2 says *“he asks questions that are never misplaced; on the contrary they are extremely well targeted and help everybody to progress; although he has no experience (in EBV’s industry) he can bring strength to the entrepreneur, a lot of strength.”* Thanks to his entrepreneurial experience, angel 3 brings valuable expertise and advice on general management issues, such as the employees’ stock option plan and the transfer prices between the French headquarters and the new US subsidiary.

Angel 2 and ID have mostly a resource provision role and specialize in areas linked to their respective experiences and capabilities. Angel 2 brings information and advice regarding the US software market, as he already set up and managed two US subsidiaries of French software firms. ID brings general entrepreneurial experience, as well as strong industry knowledge and a network of personal contacts. In fact, ID’s contribution to resource provision is mostly informal. The qualitative analysis of the interviews shows that other board members seem not to be aware that entrepreneur 1 and ID have frequent informal meetings.

It is worthwhile noting that, one year after initial board formation, entrepreneur 1 values the sounding board and counseling roles played by the board, although he did not expect a lot initially: *“... I did not think the board would bring anything to us. For me it was a one-direction process: we inform them, they are investors, we had no choice, they had to enter to bring us money (...).*

Maybe I push it a bit too far, but this is what I had in mind. Now I think I solicit them more than I thought (...) They bring a bit more."

CONCLUSION

Our study yields several interesting results concerning early board formation and roles in young entrepreneurial ventures. Combining corporate governance and entrepreneurial finance, we propose a theoretical model linking stakeholder's characteristics (financial stakes, capabilities, identity) and their respective contributions to the formation of the board, to its work routines and to its roles. We confront the model with a longitudinal in-depth case study of a young venture raising external equity for the first time from a group of business angels and venture capital funds.

The board formation process is led by the venture capitalist who played a leading role in the organization of the financing round, regarding both the formation of the group of investors and the negotiation process with the venture's founders. Not all investors join the board. In fact two main conditions seem to prevail for seeking membership: (1) having the required capabilities for contributing to venture success through complementary potential monitoring or resource provision roles (these capabilities have often been shown during the negotiation process) (2) having a strong "shareholder" identification, probably because the latter is necessary to provide the required motivation to act as board member. Previous research shows that the business angel population is heterogeneous. This is confirmed by our study regarding the degree of identification with "shareholder" status, which significantly differs from one angel to another.

The formal board routines are co-constructed by the entrepreneur/CEO and the board members who most strongly identify themselves with shareholders and are prone to monitor management, with practically no contribution by the other members. The observation of evolving board routines shows that certain members participate in two parallel processes of interaction with the entrepreneurs. Formal board meetings essentially serve the purpose of regular monitoring, whereas certain board members contribute to resource provision in parallel informal interactions, when they strongly identify themselves with entrepreneurs as a social group. One important angel-investor does not join the board because he identifies himself more strongly with entrepreneurs than with shareholders as a social group. He directly provides resources to entrepreneurs through informal mentoring.

The roles played by the board members are influenced by their capabilities and their social identification. Venture capitalists (and an angel with strong shareholder identification) are much more involved in monitoring than the other members. However, the fact that some board members are strongly involved in both monitoring and resource provision shows that these two roles are not mutually exclusive.

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FIGURE ONE
Entrepreneurial finance and the nascent board: a conceptual framework

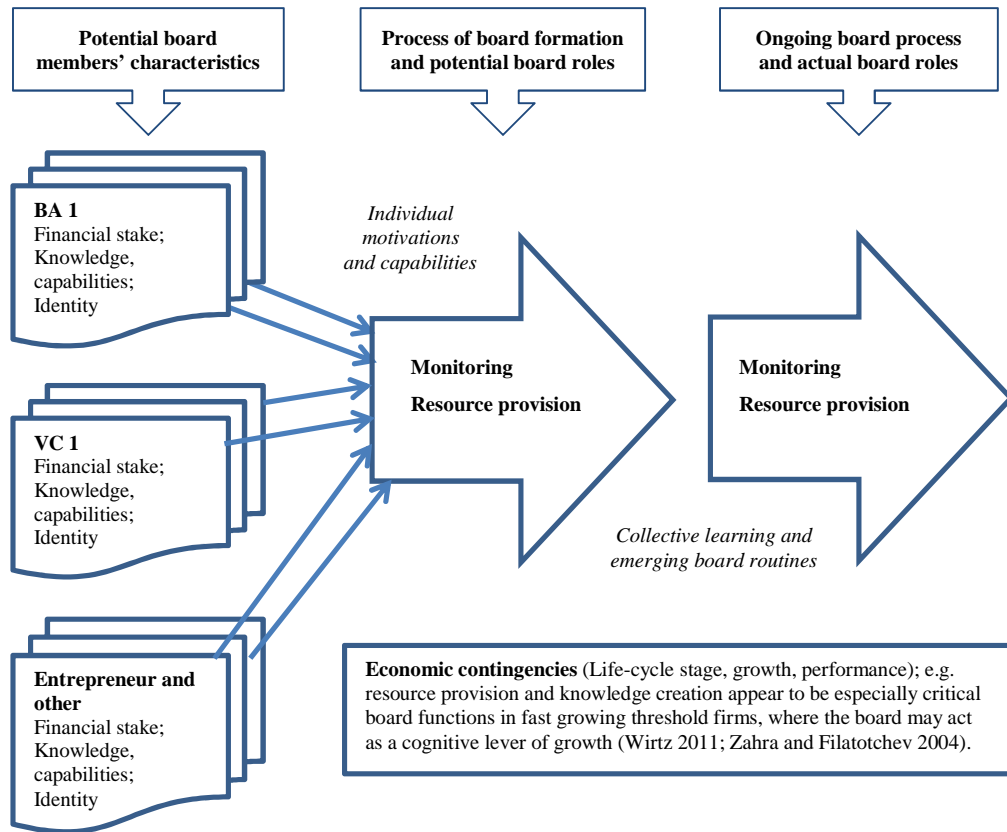


TABLE ONE
EBV case actors

Actor	Background	Interviewed at stage:			EBV board member	EBV shareholder
		Pre-round	Round	Post-round		
Entrepreneur 1	EBV co-founder, CEO Engineering degree, worked in large IT firm	✓	✓	✓	✓	✓
Entrepreneur 2	EBV co-founder, CTO Engineering degree, worked in large IT firm	✓	✓	✓		✓
Angel 1	PhD (computer science), research Founder of a technological venture		✓			✓
Angel 2	Management degree Co-founder of a technological venture Presently CEO for America of a			✓	✓	✓

	French software company										
Angel 3	PhD in pharmacy Successful entrepreneur in life science Manages a family VC fund			✓			✓		✓		
Angel 4	Academic/consultant										✓
Capitalist 1	Local VC (managing partner) Initially a business school teacher 30 year experience in VC			✓		✓	✓		✓		
Capitalist 2	National VC (partner) Management degree 12 year experience in VC			✓		✓	✓		✓		
Capitalist 3	National VC										✓
Independent director	Serial entrepreneur / angel investor						✓	✓			

TABLE TWO
Number of references coded per item and per actor

	E1	E 2	Angel 1	Angel 2	Angel 3	Angel 4	C 1	C2	C 3	ID	Total
Interests-Financial Stakes	4	1	1	4	6	1	16	17	1	0	51
Knowledge-Capabilities :											
Entrepreneurial	9	6	10	14	21	2	7	4	1	12	86
Functional-business development	7	4	14	21	9	1	16	16	2	15	105
Functional-corporate finance	6	2	2	3	6	3	18	19	2	2	63
Functional- technology development	3	2	5	3	1	0	2	0	0	2	18
Identification :											
Identification with entrepreneurs	6	3	7	8	28	0	7	4	0	11	74
Identification with industry	1	2	9	6	19	0	14	12	1	9	73
Identification with shareholders	1	0	5	5	11	2	9	17	2	3	38
Identification with directorship	2	0	1	0	2	0	4	1	2	0	12
Identification with stakeholders	0	0	0	0	0	0	0	0	0	0	10
Process of board formation :											
Board formation-membership	13	9	50	23	38	9	62	39	7	18	268
Board formation-routines	25	15	18	24	21	3	25	28	4	24	187
Board Role :											
Resource provision	20	10	35	40	36	10	31	22	5	29	238
Monitoring	10	9	0	8	17	1	16	15	4	2	82
Economic contingencies	3	0	0	3	2	0	6	4	0	1	19
Total references	107	63	157	162	217	32	233	198	31	128	

N.B. Coding was conducted independently by two authors with NVIVO software. Each coded reference was given at least two codes: one concerning an item of the model and one for the name of the actor concerned by the reference. Absolute figures in the table indicate the number of references coded for a given item.