

2 Basic concepts and terms

2.1 Technology-based startups

One important factor of the research questions is the term 'startup', which may require some further explanations due to the lack of a common understanding. The term itself is frequently used in the research field of entrepreneurship, which was shaped by Schumpeters basic and widespread definition: *"The function of entrepreneurs is to reform or revolutionize the patterns of production by exploiting an invention or, more generally, an untried technological possibility for producing a new commodity or producing an old one in a new way, by opening up a new source of supply of materials or a new outlet for products, by reorganizing an industry and so on."* (Schumpeter 1942, p. 13). In his understanding entrepreneurs introduce innovation to markets. However, entrepreneurship in this sense would not be connected to the age of a company, but much more to their activities. Although he later on explains that with the increasing organization of established firms managers lose their entrepreneurial mindset. Another basic definition by Kirzner (1973) defines entrepreneurs as people who cope with uncertainties and imperfections of markets to reallocate resources in more effective ways in order to gain economic advantages. Contrary to Schumpeters view Kirzner is less focused on product innovation and thus includes service innovation.

To operationalize these basic concepts in this study, startups are understood as *"[...] is a human institution designed to create a new product or service under conditions of extreme uncertainty"* (Ries, 2011, p. 27). Moreover, it is necessary to limit the age of the company as reaction to Schumpeters idea that established businesses lose their revolutionizing behavior. Thus, the age limitation should not be too small and cover several years of technology development as well and also allowing for measuring (performance) trends as well as changes during entrepreneurial development. According to the 'German Startup Monitor' published by Ripsas/Tröger (2015) startups are firms that utilize an innovation (either a technology or business models), that want to achieve significant growth in terms of sales and employees and that are not older than ten years. This definition of the relevant firm age will be adopted in this study. It must be mentioned that especially the length of the

entrepreneurial phase is part of a lively debate and other authors such as Schmidt (2002) limit it to five years.

Another important term used in this study is the term 'technology-based'. This fits very well to the notions of Schumpeter (1942) and Kirzner (1973) who emphasize the newness and degree of innovation in entrepreneurial contexts. Similar considerations have caused the development of the term "newly-founded technology-based firms" (NTBFs) that has frequently been used in studies on entrepreneurship such as Pinkwart/Proksch (2013). By nature, using a new technology refers to a certain degree of innovation. At the same time the involvement of technology adds a certain complexity, both managerial and in terms of resources. From a managerial perspective technology-based firms have to consider a more complex structure as it can be seen in the addition of positions such as the "Chief Technology Officer" (CTO) or research and development departments. Moreover, it is usually necessary to acquire more resources to develop, use and diffuse a technology than in the case of non-technology-based firms, resulting in a higher likelihood of external financing, often through VC (Schmidt 2002, Carysee/Knockaert/Lockett 2007). Because they usually influence the governance structures of a company (see chapter 3.5), the concentration on technology-based startups narrows down the investigation to a group of companies where the problem is especially relevant. Therefore, higher technological complexity in knowledge-intensive technology-based firms can lead to managerial complexity (Erakovic/Tchaka 2010). To structure data generation and data analysis this study concentrates on three typical industries that are affiliated with the term 'technology-based': the Good-producing sectors, Life Science and Information and Communication Technologies (ICT). Each focus industry shall be shortly introduced:

- **Information and Communication Technologies (ICT):** defined as information-technology- or software-based companies including online businesses and ecommerce and related services
- **Life Science:** defined as research-based producers or developers of chemical or biological products including biotechnology, medicine, health
- **Good-producing sector:** defined as producers or at least developers of touchable technical goods and products or related services

It must be mentioned that the degree of innovation matters much more than the concrete industrial sector.

2.2 Governing boards in one- and two-tier corporate governance systems

If the term 'governing boards' is used in this study, it shall cover BODs, SBs as well as ABs and thus it is used as umbrella term. Besides the entrepreneurs themselves, governing boards are an additional managing body of a company. In a very simplified way corporate governance refers to the institutions and activities to manage a company and besides governing boards it also refers to power mechanisms, top management teams, management practices and many other fields. After some very influential and popular corporate failures and after the latest financial crisis 2008, the topic of corporate governance gained increasing importance for academics and practitioners worldwide (Mallin 2010). In the past the term corporate governance was mainly associated with financial performance (Zahra/Pearce 1989, Daily/Dalton 1992, Bammens/Voordeckers/ Van Gils 2008), referring to investment-oriented definitions such as the one by Shleifer/Vishny (1997) who said: *"Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment"* (Shleifer/Vishny 1997, p. 737). In addition to monitoring performance, other mechanisms that shape the external relationship of companies with stakeholders and the internal aspects of interacting bodies inside a company are relevant to explaining good governance structures (Mallin 2010). Leadership and power aspects, such as the relationship between chief executive officers (CEO), BODs and corporate performance (Zahra/Filatovchev 2004) are also discussed under the umbrella of corporate governance. Following a definition by the Organisation of Economic Co-operation and Development (OECD) *"[c]orporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined"* (OECD 2004, p. 11).

Corporate governance research is influenced by different regulatory environments determining the nature of governing boards as well as other corporate governance mechanisms. In general, there are two different corporate governance systems applied in different parts of the world. While a one-tier or unitary board is predominant in states such as the US, the United Kingdom and the majority of the European Union states, the two-tier or dual board is used in Germany, Austria, the Netherlands or Denmark among others (Mallin 2010).

One-tier systems are characterized by a single board, which includes executive and non-executive members called directors (Mallin 2010). Hence this BOD is in charge of all company activities and each director is working to achieve the same company objectives. This allows a close relationship between all directors and a good information flow between them. Directors are elected by the shareholders at an annual shareholder meeting. In the two-tier system the governance structure is split into an executive or management board and a SB (Shleifer/Vishny 1997, Mallin 2010). Thus, there is a clear separation of management and monitoring that can never be executed by a single person. This formal distinction avoids conflicts of interest. The management board is responsible for running the business, while the SB sets and monitors the business. In opposite to directors in one-tier systems, not all governing board members are directly elected by shareholders. While shareholders only appoint SB members, the SB itself elects the management board members. In addition, in some legal frameworks such as in Germany and dependent on the legal form and total number of employees, representatives of employees have to be invited to join a SB. Therefore, it is similar in both systems that members of the BOD or SB, who are in both cases elected by the shareholders, delegate authority to a group of managers and both are responsible for financial reporting, control systems and legal compliance (Mallin 2010). But while this group of managers stays part of the BOD in one-tier systems, they build a new body of the company called the management board in two-tier systems. Furthermore, members of mandatory boards are legally liable.

From the theoretical perspective it is not clear whether a one-tier or two-tier system leads to superior corporate governance practice and effectiveness. Rather both systems have advantages and disadvantages (Bezemer et al. 2013). There is a

trade-off between the high ability to control, to provide services and to support strategy due to small information asymmetries in one-tier systems and the independence of those issues in two-tier systems. However, the current debate predicts a convergence of global corporate governance systems due to new harmonized corporate governance standards (Rasheed 2012). Also ABs are one example for an corporate governance practice, which can be found in both systems. While entrepreneurs have no choice if they are forced by law to set up a mandatory board, there is no regulation requiring ABs in both systems.

The following table summarizes the key characteristics of the three governing board types that will be discussed in the following chapters.

Table 3: Features of different board types in one- and two-tier systems

	Board of Directors (e.g. US)	Supervisory Board (e.g. Germany)	Advisory Board
CG system	One-tier	Two-tier	One- & Two tier
Regulation	Yes	Yes	No
Introduction	Mandatory for Inc. and LLC in most states	Mandatory for AG and GmbH with more than 500 employees	Voluntary
Typical size	Medium	Bigger	Flexible, typically smaller
Nomination	Elected by shareholders	Elected by shareholders and employee representatives	Usually appointed by management
Liability	Yes	Yes	No (in general)
D&O insurance	Yes	Yes	Usually no
tasks	Management	No	Flexible
	Control	Yes	Flexible
	Advice	Intrinsic	Minor role in practice
Committees	Legal necessity	Recommended by DCGK	Flexible, usually no

(Source: own illustration)

2.3 Voluntary and forced advisory boards in both one-tier and two-tier systems

By law, the introduction of ABs is completely voluntary in most one-tier systems like the US (Nash 1988, Blumentritt 2006, Hawfield/Zaepfel 2013) and in most two-tier systems such as Germany (Klaus 1991, Höppner 2006, Kuck 2006). Thus, there is a high flexibility to design and organize ABs according to the special needs and environment of a company as long as it does not restrict other mandatory bodies of

the company. For example in German regulation the paragraphs 37 and 52 of the limited liability companies act (GmbHG) and the stock corporation act (AktG) build the basis for implementing ABs and assigning certain rights and duties. This is only possible as long as a company does not grow to a size where it is targeted by regulation. Therefore, it is the underlying understanding in this study that by definition all governing boards which are not required by legal regulation can be subsumed as ABs regardless of their actual function.⁹ Due to the flexibility regarding its functions, ABs can have many different names in practice such as ‘advisory council’, ‘family council’ or ‘facultative supervisory board’ and German counterparts.¹⁰ Moreover, the high flexibility of ABs causes innumerable opportunities but also threats. In opposite to mandatory boards AB members do not possess any authority as long as it is not granted by company bylaws. In return AB members are typically not legally responsible. Depending on the company statutes they are appointed by the executive management or by shareholders.

Compared to mandatory boards ABs offer many advantages. First of all, because of the legal flexibility they are not constrained to the requirements of BODs or SBs with defined responsibilities in given fields (Fox 1983, Dimma 2000, Sherman 2002, Walker 2012, Hawfield/Zaepfel 2013). While BODs have to fulfill a number of tasks by law, ABs can focus on special fields and topics, which may be brought to a BOD agenda later on (Reiter 2003). Thus, it is possible to adapt an AB according to given circumstances and to complement and adjust legal environments (Grundeir/Talaulicar 2002). In the context of early-stage startups it is worthwhile to mention that ABs can be adapted in a way that the decision-making power remains in the hand of the management, while the AB mainly fulfills additional functions. An entrepreneurial company can still react very fast and flexible on market needs, which is one of their most important advantages. Compared to mandatory boards, ABs are cheaper, since

⁹ Other authors like Marshall/Heffes (2003), Carter (2008) or Drew (2012) describe an AB as a kind of marketing-board, which differs from the ‘ordinary’ AB by being considerably bigger, but having fewer meetings, by only containing marketing partners, by having a project team character and by a strong focus on product and service development. Moreover, publications on these customer or supplier ABs are rather anecdotal. Thus, the present thesis explicitly excludes these kind of ABs that are strongly related to marketing issues and it concentrates on corporate governance relevant AB interaction with the top management of companies.

¹⁰ Typical German expressions are ‘Beirat’, ‘Familiennrat’, ‘fakultativer Aufsichtsrat’, ‘freiwilliger Aufsichtsrat’ and others.

the compensation of AB members is typically lower when they are not directly liable (Reiter 2003, Hawfield/Zaepfel 2013). Since potential candidates for BODs or SBs may require extensive Directors and Officers (D&O) insurance, many of them are too expensive especially for small startups. Also due to lower responsibilities, it is easier to find and recruit valuable AB members, who are willing to spend their time, expertise as well as name to a company (Tillman 1988, Ward/Handy 1988, Morkel/Posner 2002, Barringer/Ireland 2010) and it may cause a higher motivation to act very openly and collaboratively (Hawfield/Zaepfel 2013). Considering the current trend to put additional responsibilities and liability on mandatory boards, this advantage may catch additional importance in the future especially in one-tier systems. The next advantage of ABs is the flexibility when it comes to nominating or removing members (Fox 1983, Heidrick 1988, Tillman 1988, Buchholz/Crane/Nager 1999, Merkel/Posner 2002, Hawfield/Zaepfel 2013). Although directors in BODs and members in SBs are usually elected yearly, they frequently have tenure till they retire due to inertia and social relations (Kor/Misangyi 2008). Contrary, AB members usually have a shorter term. Therefore it is more convenient to adapt the composition of ABs when corporate government requirements have changed for example during the entrepreneurial development process (Clarke/Klettner 2009). However, in reality changing AB members might also be a critical issue due to social relationships and processes.

On the other hand, ABs also can have considerable disadvantages. If an AB is established next to mandatory boards, they are usually not strictly separated and thus overlapping occur that causes confusion or competition between these entities (Dimma 2000, Lambrecht/Lievens 2008). Typically members of voluntary are not granted authority and therefore the acceptance by managers, employees or members of other governance boards could be reduced in some cases and relies on the institutional anchoring (Blumentritt 2006, Höppner 2006). This might be different for forced ABs that are granted various rights within the statutes of a company or investment contracts. Without liability there might be a negative impact on the motivation and time commitment of individual members (Louden 1986, Blumentritt 2006) or it could cause a tendency to provide advice and control less carefully and overconfidently compared to liable mandatory board members. Another aspect is that

in companies without mandatory boards the owner-manager has the burden to carry all liability alone causing higher conservativeness and risk-avoidance in decision-making with potential negative influence on growth and profitability (Louden 1986).

In practice there are different occasions that shape the decision of founding an AB. On the one hand, this decision can be freely made by the management team of a company (voluntary AB) or on the other hand it can be required by third parties such as shareholders (forced AB) influencing the roles and functions of the AB (Thümmel 1995). Although this differentiation might not cover the broadness of AB practices in companies, it is a helpful approach that covers the extreme points of a continuum.

2.3.1 Voluntary advisory boards

Due to the regulatory freedom, managers can freely decide if they introduce a voluntary AB and shape the roles and functions of it according to their individual demand. For example, experienced AB members such as professors could be utilized as advisors on technical issues within product development. Typically in university spin-offs professors support the entrepreneurial endeavor through transferring their know-how and thus they foster an interorganizational direct technology transfer from universities to startups (Pinkwart 2002, Pinkwart/Heinemann 2004). Thus, other authors like Isaacson/Mitchell/Star (1994), Morkel/Posner (2002) or Elfring/Hulsink (2003) refer to this special type of AB as “scientific AB”, which can be often found in knowledge-intensive startups, especially in the Life Science industry.

Moreover, there are differences in one- and two-tier systems of corporate governance. In one-tier systems voluntary ABs can be established as a complementing body parallel to mandatory BODs (Dimma 2000). In those cases the main objective of those voluntary ABs is to assist the executive management by advising in various questions, while it still remains the main objective of BODs or SBs to represent the interests of shareholders (Morkel/Posner 2002). In one-tier systems young companies with growth aspirations also introduce ABs to steer transition and as prearrangement for BODs or as a candidate pool for BODs (Dimma 2000, Sherman 2002, Minichilli/Hansen 2007). Especially prominent candidates might prefer a seat in an AB rather than one in a BOD, because they have to carry less

responsibility and liability (Morkel/Posner 2002, Walker 2012). Therefore, most ABs in one-tier systems are voluntary ABs. In two-tier systems an AB can be either voluntary ABs to benefit from the service role such a governing board may offer (see chapter 3.2.2) or they are required by third parties with a higher importance of task related to the control role (see chapter 3.2.1).

2.3.2 Forced advisory boards

While BODs in one-tier systems offer a legally required opportunity for shareholders to influence and maintain their investments, at least in Germany there is not such a mandatory instrument for shareholders of small limited liability corporations (Gesellschaft mit beschränkter Haftung, GmbH). Since this is the most relevant legal form for startups in Germany, there is empirical evidence that ABs in two-tier systems are used as a supplement of BODs and thus to adapt the given legal framework (Grundeis/Talaulicar 2002). Empirical findings of Schefczyk/Gerpott (2001) showed that 87 percent of VC-backed firms – and often technology-based ventures are VC-backed – have a VC representative in either an AB or SB. Therefore, a high share of VC-backed firms must have an AB, since German startups are relatively seldom founded as stock corporations with legally required SBs (Grundeis/Talaulicar 2002). This also holds true for family businesses, when especially after the first generation, some successors or invested private equity funds may encourage the second generation to have family representatives in forced ABs. If ABs are established as a requirement of shareholders they might encourage ABs to perform a control role and put less emphasis on service aspects as in voluntary ABs. In those cases business experts or shareholder representatives control the financial development of a company as AB members. It is noteworthy to mention that the term ‘advisory’ board thus can be misleading, because it refers to an advisory function which either can be important in some companies or which can be completely inappropriate in other cases. In fact, many corporations have forced ABs where monitoring is the most important task. But even in the case of forced ABs they can also provide services such as advice and networks and shareholders do not need to overemphasize control (Schefczyk/Gerpott 2001, Grundeis/Talaulicar 2002).

2.4 Boards of directors in one-tier systems

To describe some characteristics of BODs in detail, the following chapter focusses on the US regulation, where the single states incorporate most businesses. However, many aspects can be transferred to most one-tier systems. Depending on the state, the introduction of a BOD is mandatory by law for both public and private companies to protect the interests of the shareholders (Nash 1988, Conger/Lawler/Finegold 2001, Sherman 2002, Shultz 2007). Since the Sarbanes-Oxley Act (SOX) was introduced in 2002, most states require a BOD for limited liability corporations (LLC) and for Corporations (Corp.) or Incorporations (Inc.) as public legal forms (Cagan 2012). Recent regulation including the SOX or other rules and laws given by the Security and Exchange Commission (SEC), the New York Stock Exchange (NYSE) or the National Association of Security Dealers (NASD) favor the idea of independent outside directors to perform a strong control function (Duchin/Matsusaka/Ozbas 2010). Since 1999 the stock exchanges require that the audit committee of the BOD must consist completely of outsiders and since 2003 half of the overall BOD must be independent directors.

Although they can delegate authority to the management, directors have fiduciary duties. Firstly, they have a duty of loyalty, which means that they are only allowed to exercise power in the interest of the firm and not for personal benefits, as well as their role requires full disclosure and confidentiality. Furthermore, directors have a duty of care or diligence to act in good faith and in the best interest of the company, to be honest, to gather adequate information, to join meetings regularly and to establish control mechanisms. In addition, there is a duty of fairness when it comes to transactions between a company and a director or companies owned by him or her. Such transactions have to be ratified and approved by a majority of the board. Finally, directors have a duty of obedience referring to compliance with statutes and terms of the company. Given these legal responsibilities and existing customs, traditions and practices, directors are usually engaged in the following activities among others (Conger/Lawler/Finegold 2001, Shultz 2007):

- Confirmation: changes in company bylaws, emission of shares, dividends or repurchasing programs, mergers and acquisitions, sale of substantial assets, major corporate actions and strategy
- Advice: providing counsel to executives
- Oversight: controlling management performance by setting objectives and measuring results, monitor investments, ensure legal compliance
- Decision: (if necessary) selecting and removing executives, creating compensation structures, setting up auditing procedures, selecting auditor and audit committee
- Inform: gaining sufficient information level, ensuring stakeholder interests in board meetings and decisions

To ensure efficiency BODs establish committees as subgroups, which recommend actions to the complete BOD in the case of special issues. The most common committees are an audit committee that selects the auditors, sets auditing requirements and controls the audit process, a nominating committee that appoints executives as well as directors, and a compensation committee assembling incentive structures.

2.5 Supervisory boards in two-tier systems

Two-tier systems are much more diverse than one-tier systems and in practice there are various adaptations in many different countries. The following descriptions are based on the German regulatory environment, where SBs are mandatory for stock corporations. But also other countries like Austria (Mitter/Duller/Feldbauer-Durstmüller 2012), the Netherlands (Bezemer et al. 2013) or Denmark, Japan and Taiwan (Yeh/Taylor/Hoye 2009) have two-tier systems with more or less substantial differences to the German regulation.

Besides laws like the German Stock Corporations Act (Aktiengesetz) or the Co-determination Act (Mitbestimmungsgesetz) corporate governance issues are influenced by national and international soft rules or codes such as the German Corporate Governance Code (DCGK). Additional institutional statutes and individual contracts are also determining corporate governance practices in companies (Von Werder/Talaulicar 2006). In Germany the SB is accompanied by a separate management board (also called executive board) and the shareholder meeting. Members of a SB are not allowed to parallelly participate in the management board

and vice versa. While the BOD in one-tier systems like the US can be found in most companies, the share of companies with SBs is smaller in two-tier systems such as Germany, since the mass of SMEs does not need to build SBs. By law only stock corporations (Aktiengesellschaft, AG) and limited liability corporations with more than 500 employees are forced to introduce SBs. In Germany the limited liability corporation is the dominating legal form, especially for SMEs and family businesses (Grundeis/Talaulicar 2002, Höppner 2006, von Werder/Talaulicar 2006).

Another specialty of German regulation is the employee participation in SBs, which is guaranteed by the so-called One Third Participation Act (Drittelbeteiligungsgesetz). This strong regulation shows the great influence of regulation on SB activity and its importance for ensuring not only shareholder benefits, but also the consideration of stakeholder interests. By law it is the main duty of SBs to supervise the management, although advice is legally permitted. However, there are restrictions to advice and strategy setting, especially if the SB takes the strategic leadership of the company (Grundeis/Talaulicar 2002). Whereas the management is responsible for day-to-day business and strategy setting, the SB mainly has the following functions (Von Werder/Talaulicar 2006, Jaskiewicz/Klein 2007, DCGK 2014):

- Confirmation: coordinated strategy set together with the management board, confirming decisions that fundamentally influence assets or financial issues
- Advice: providing counsel to management board
- Oversight: supervising management board, coordinate their work
- Decision: appointing management board, removing management board members if they neglect their duties, if they have significant lacks of ability and experience or if they are not discharged by shareholders, selecting auditor(s)
- Inform: gaining a sufficient information level, defining the information duties of management board

The DCGK suggests introducing an audit committee as well as a nominating committee. Especially the co-determination of employees within German regulation gains criticism from theorists, because it leads to very large boards with more than 20 members. Hence, the awareness of different topics might be biased towards labor issues, employee representatives may not have a sufficient level of knowledge, ability and experience, but hidden agendas and in international companies the

representatives of the domestic workforce may especially consider interests of local employees and not those of international colleagues (Von Werder/Talaulicar 2006).

2.6 Different types of advisory board members

An inherent part of an analysis of ABs is the question who serves in ABs both in terms of their background and in terms of their relation to the company.

In family businesses most ABs include at least one member with a family background (Höppner 2006, Achenbach/May/Rieder 2009, Lamsfuß/Wallau 2012). But with the growing age and size of a family business, the number of external members increases (May/Lehmann-Tolkmitt 2006). Contrary, there is evidence that entrepreneurial technology-based firms rarely have AB members with family backgrounds (Grunde/Talaulicar 2002). Instead, Morkel/Posner (2002) examined that seed investors with a small amount of money typically join ABs in US startups, while major equity investors in later phases are typically members of BODs. For German startups, Schefczyk/Gerpott (2001) confirmed VC representatives as typical members. Due to financial restrictions, especially in small, but growing companies, business friends or family members can be a cheap and trustworthy alternative to advice entrepreneurs, but only if they possess the required expertise (Robson/Bennett 2000). In most cases those internal members have either direct interests, for instance as shareholders or they have personal commitments to the management. Hence, in many cases outside members are invited, including previous founders, current CEOs or entrepreneurs from other companies, senior executives as well as members of other governing boards (Morkel/Posner 2002, Lamsfuß/Wallau 2012). In addition, leading scientists are frequent AB members in some knowledge-intensive industries, who provide deep technical expertise and resources, but may have a lack of business expertise and focus (Krimsky/Ennis/Weissman 1991, Isaacson/Mitchell/Star 1994, Morkel/Posner 2002). Also consultants, accountants, tax advisors or lawyers are popular AB members, especially in smaller firms (Fox 1982, Höppner 2006, Lamsfuß/Wallau 2012, Power 2014). However, each type of candidate has various advantages and disadvantages.

- Based on BOD research it is reasonable to assume **VC representatives** might change the role of a (forced) AB towards control, although they also advise the managers and open their networks in the interest of their portfolio companies.
- Since external members generally add wisdom, experience, creativity and contacts, which complement experiences and resources of the founding team (Carpenter/Westphal 2001, Hawfield/Zaepfel 2013), **experienced entrepreneurs or managers** provide positive inputs and reputation, but they often have limited time resources (Henseler 2006, Woywode/Keese/Tänzler 2012).
- Other outsiders like **consultants, lawyers, accountants, tax advisors**, who are often hired anyways, are typical AB members in small firms. Often they do not add value to their contractual mandate and they have conflicts of interest when the ABs has a control role, since it becomes unclear which part of their work is related to their consulting activities and which to their AB engagement (Jonovic 1989, Sherman 2002, Henseler 2006, Walker 2012, Hawfield/Zaepfel 2013). But in practice startups sometimes even engage those professionals against an equity share.
- In the context of SBs Oehmichen/Schult/Wolff (2014) revealed that **former executives or top-managers** as board members have negative effects on monitoring, but positive effects on the provision of advice.
- Despite their high acceptance by managers of family firms, the neutrality and expertise of **family members** is questionable and if they are already members of the shareholder meeting (mostly in family businesses) their added value as AB members is small (Henseler 2006, Woywode/Keese/Tänzler 2012). Furthermore, overlapping family and professional business roles can cause confusion and support informal parallel structures (Nordqvist 2011). Due to personal relations family members tend to confirm management decisions and it is complicated to replace them if necessary (Sherman 2002, Henseler 2006, Shultz 2007).

Besides their professional background, AB members can be categorized by the relation between them and the company, which is eventually linked to their independence. While insiders are the executive management of a company, major shareholders of a company and representatives of other stakeholders such as unions, employees or big lenders, Kor/Misangyi (2008) define outsiders broadly as “*non-management members of the board*” (Kor/Misangyi 2008, p. 1345). In practice these outsiders are typically presidents or senior executives of other firms, retired business people, professional advisors, academics or also friends and spouses (Ward/Handy 1988, Buchholz/Crane/Nager 1999). This basic definition is only based on formal membership, but not on the various interpersonal relations that may shape independence. Generally, such broad definitions are widely used, since they appear to be very clear, but theorists are still far away from a consistent measurable operationalization (Johnson/Daily/Ellstrand 1996). Adding further constraints to this approximation, Brunninge/Nordqvist (2004) distinguish independent governing board members, who are neither employees nor family members, from outsiders, who are not employees or managers, but maybe socially dependent family members. Further specified, retained consultants and close friends of top managers can be excluded from the list of truly independent outsiders (Schwartz/Barnes 1991). To include the dependence caused by social or professional ties of governing board members, other authors like Johnson/Daily/Ellstrand (1996), Hillman/Keim/Luce (2001), Peng (2004) or Coles/Daniel/Naveen (2008) refer to the notion of affiliated (outside) members, who are characterized as non-management members that have a family or business relationship with a company or its managers and are not independent. Due to potential conflicts of interest affiliated members are generally seen as less effective supervisors, but still contribute as advisors or strategists (Dalton et al. 1999). Typical examples of affiliated members include professional consultants such as lawyers or investment bankers, suppliers, former employees, family members or creditors.

Furthermore, shareholders and especially representatives of investors have to be distinguished due to their special interests and behavior. Thus, investor representatives can be considered as affiliated outsiders, because they are usually not part of the executive management team, but at the same time they are not completely independent, because they have their own interests that might not represent the

majority of shareholders. Therefore, investor representatives can be seen as an additional type of governing board member that has been explicitly addressed in only some publications (e.g. Rosenstein et al. 1999, Deakins/O'Neill/Mileham 2000, Schefczyk/Gerpott 2001, Filatotchev/Toms/Wright 2006, Clarke/Klettner 2009, Bygrave/Zacharakis 2014). In the present study independent outside AB members such as experienced entrepreneurs or professors will be separated. This differentiation allows distinguishing governing board members, who are completely objective if they do not have personal ties, and investor representatives, who could have their own interests, which might differ from those of the organization as a whole and all of its shareholders in particular. The following understanding will be used as a preliminary definition:

- **Insiders or affiliated members:** Members who are at the same time executive managers or employees of the company or affiliated with managers.
- **Investor or VC representatives:** Members who are directly invested as shareholder into a company or their partners, employees or third parties they send to secure their interests.
- **Independent outsiders:** Members who are neither insiders nor investor representatives and who are unaffiliated and have no direct interests.

However, along with changing requirements of corporate governance and the changing role of governing boards, also the function of ABs is not constant through the entire life cycle of a business and thus the statutes, processes and cast of ABs need regular updates (Isaacson/Mitchell/Star 1994, Höppner 2006). While in early phases entrepreneurs, who successfully mastered comparable tasks, and specialists with expertise in required topics are the best candidates, in later phases of (family) businesses senior managers of larger firms are appropriate and often it becomes unavoidable to invite family members.

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