Prospecting a CEO and the Role of Good Governance.

Corporate Package Case Study

Executive Summary

Good corporate governance is an important discipline for all startups at all stages of their lifecycle. Good governance often precipitates growth because people (both internal and external) are more likely to have confidence in a company that makes its decisions in transparent and accountable ways. This study highlights the importance of good governance even at early stages and just before experiencing rapid growth and infusion of investor capital.

Typically, once a company starts to become successful the next step would be for the founding team to fill the gaps in experts and leadership teams necessary to take the company to the next stage. When a company decides to prospect a key role like Chief Operating Officer (CEO), it is important to ensure that the company's governance processes are in good form and the terms of the new role are clearly documented. You want to create the best first impression of your company if you want to win a great CEO prospect as the next leader who will be taking your company to its next height.

Challenges

Hiring a CEO from outside is one of the most significant decisions a founding team will engage in. Some things to remember and questions to answer in that process are: 1) evaluate the strengths and gaps in the team and agree on who will remain as founders and C-Levels going forward; 2) who will be willing to voluntarily resign if needed; 3) who will agree to negotiate possible exits and equity returns to treasury; 4) what are the terms under which the exits and capital returns or equity buy-backs are arranged; 5) how much equity can you get released so you can allocate all or a part of it to the new CEO whose compensation package often include a heavy equity component; 6) what compensation should be given to the new CEO (cash, restricted stock, equity, etc.); 7) has the company got a stock option plan in place for compensating key hires; and 8) Are all the key decisions documented in governing documents?

Illustrative Case

TeqLaa™ recently handled a scenario in which a fast growth early stage company (**RhinoHorn**), a Delaware C entity, had to catch up with its corporate formalities before it was able to prospect and onboard a new CEO. The founding team prospected several CEOs before they zeroed in on a candidate who flew in from a foreign location to meet the founders and spent a significant amount of time getting to know the company, team, operations, and its vision. The result was a new strategic direction and vision for the company, lead by a new CEO and leadership team. Though the founding team of RhinoHorn had a compelling vision and experienced fast growth, they encountered several setbacks before they were able to extend a solid offer to the new CEO due to the need to first complete corporate formalities and internal record keeping.

In order to prospect and onboard the new CEO, the leadership team worked closely with TeqLaa team to get the internal records cleaned up and governance formalities completed. Listed below are examples of some of the corporate governance issues handled and completed by TeqLaa team prior to bringing on the new CEO for RhinoHorn:

1) Facilitating discussions with founding team on desired leadership roles played by founding members going forward.
2) Facilitating successful and friendly exits of founding members as desired.
3) Completing governance formalities in their order through certain founding team exits with appropriate exit terms, resignations, capital returns, release, and indemnifications.
4) Legal structure and agreements that facilitated prospecting the new CEO (e. g., Non-disclosure with prior IP disclosure, feedback and residual clauses, non-binding Memorandum of Association (MOU), consulting agreements covering the prospecting period, etc.).
5) New CEO Employment Offer with a compensation package which includes equity, roles and responsibilities, expectations, commitments, permitted non-compete restrictions, conflicts of interest, proprietary information and invention assignment agreements (PIIA), Restricted Stock grants, and terms of employment.

Results, Strategies and Future Plans on Dealing with Clients

Many lessons were learned and strategies were adopted through the process of staging the startup for prospecting the new CEO to onboarding the new CEO. From handling corporate governance formalities on exits of founding members, new team building, to onboarding the new key executives, each step has to be planned ahead and completed according to a well planned sequence of events. Below, you will find a few '**Best Practices**' that would be helpful when negotiating terms on exits of key executives and prospecting and onboarding a new key executive.

Best Practices on negotiating exits:

1) Always keep things positive and friendly. Consider certain exits as a good thing in that the exit is viewed as a new opportunity for exiting members to pursue their own truly passionate causes versus a forced exit.
2) Attempt to be always fair. Assume you are in the same scenario. What would you consider a good exit? Treat the exiting member fairly and with respect.
3) When possible, return the contributions (with a small interest % if possible). When possible, those who want to stay might want to extend a temporary loan to the company to facilitate the exits and releasing the much-needed equity to the treasury.
4) Negotiate for a transition period (usually about 90 days). Remain in touch with exits to the extent desired. Keep them informed of the progress and future plans. Ask for

their support and involvement in other ways. (E.g. as channel partners, advisors, or a consultants if desired).

5) Acknowledge the work they did to bring the company to this point and thank them. Make sure the exiting members feel appreciated for their contribution.
6) Document the exits by way of Board Resolutions while bringing the governance formalities up to date.

Best Practices on prospecting a new CEO:

1) Be open and transparent. Let him or her know of the status of the company's corporate formalities and the fact that the company is working with the legal team in completing certain required formalities. Explain the possible delays.
2) Treat the prospect CEO as the new visionary of the company from the start. Try to give the prospect the ship and watch how he or she steers it. Show your genuine interest in the new CEO's involvement in the new role.
3) Try to be as inclusive as possible from the start. If agreed, and desired by the new prospect treat him or her as part of the founding team and give a high level of involvement and ownership in the decisions making.
4) Register IP (at least provisionally) and disclosure to avoid possible IP misappropriation claims and contamination. Get the prospect to disclose his or her IP.
5) Don't let compensation rule the conversation or prospecting relationship. Watch for the right fit, leadership traits, commitment, risk taking, flexibility, cultural fit, values, connections and ability to create relationships, and the manifested desire to be truly a part of your team. However, address compensation prior to onboarding to ensure the specific terms are in writing.
6) If the new CEO is also admitted as a co-founder, ensure a Founder Agreement that specifies the way the founders agree to work as a team is in place.
7) Have similar agreements with other key executive or founding members if they are not in place already. Approve or confirm the new slate of directors and officers, as the same often tends to be different from what it was prior to onboarding the new CEO.

8) Be direct and clear about the terms of the offer which includes the following terms (in the employment agreement and offer letter):

   1) At will employment; 2) No contract of employment or tenure; 3) Duration of offer with an end date; 4) Offer is subject to the approval of the Board of Directors; 5) Clear titles (CEO, President, Director, Officer, Co-founder, etc.); 6) Roles and responsibilities (e.g., managing the day to day operations, raising funds, hiring key members, strategic decision making, etc.); 7) Clear terms on compensations and amounts with vesting terms (restricted stock, cash, stock options, benefits, other incentives, etc.); 8) specify the terms any capital investments if required; 9) pass resolutions of the Board approving the hire and election as officer and/or director as needed; and 10) Sign key agreements such as PIIA, Employment Agreement with confidentiality, non-disclosure, and finality clauses with no oral promises, etc. are valid prior to onboarding.

9) Do not attempt to skip the formalities prescribed by your legal team as they might come back to hurt your company and perhaps the most important relationship you make in unexpected ways.

Learn more about TeqLaa™ Smart Legal Solutions at www.teqlaa.com.
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