Boardroom Lessons from Theranos

By Adam J. Epstein

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Thanks to John Carreyrou's Pulitzer Prize-winning reporting in *The Wall Street Journal*, and his new book, *Bad Blood: Secrets and Lies in a Silicon Valley Startup*, few people haven't heard of Theranos. Its saga is a cautionary tale about how not to operate—or invest in—startups and a treasure trove of boardroom takeaways.

For those who don't know, Theranos vowed to revolutionize the blood testing industry by facilitating hundreds of cost-effective tests from mere drops of blood. The company raised nearly $900 million and famously reached a $9 billion valuation before the U.S. Securities and Exchange Commission and the U.S. Attorneys—both with substantive assists from Carreyrou's reporting—brought civil and criminal actions, respectively, alleging a massive fraud.

During the majority of Theranos's corporate life since 2003, the company boasted board members such as former Secretaries of State Henry Kissinger and George Shultz, former Secretary of Defense Bill Perry, former Senators Sam Nunn and Bill Frist, former Navy Admiral Gary Roughead, former Marine Corps General James Mattis, and CEOs Dick Kovacevich (Wells Fargo) and Riley Bechtel (Bechtel). With a board like that, what could go wrong?

Turns out, everything. Here are some invaluable lessons from what Carreyrou called "one of the most epic failures in corporate governance in the annals of American capitalism."

Celebrity boards. I'm usually circumspect about nascent companies that have famous, independent board members because it might be a cover-up for business weaknesses. Adam Quinton, adjunct professor at Columbia School of International Public Affairs and Policy, says prospective board members and investors should be particularly cautious of vanity board members "who lack any domain expertise in the area of activity of the company." This is because they can't provide value-added oversight. None of Theranos's directors were experts in clinical pathology or microfluidics. Some observers have mused that its board was better comprised to go to war than oversee a blood-testing company.

Hyper-secretive CEOs. During a recent law firm event, Frank M. Placenti, vice chair of the American Bar Association's corporate governance committee, remarked that, in his experience, clandestine CEOs are a red flag. Elizabeth Holmes, Theranos's founder and former CEO was renowned for personally escorting company visitors from conference rooms to restrooms, and she created operating silos within the company to ensure that certain employees couldn't interact with others.

Lack of "smart money." Medical school students often learn early in their studies that "serious diseases have serious symptoms." Similarly, successful, highly technical companies often have investors who possess a high degree of relevant expertise. If that's not the case, there's often a reason why.

There wasn't a single, well-known venture-capital firm that specializes in life sciences listed among those who invested $900 million in Theranos. Instead, the Walton family (Walmart), Rupert Murdoch (News Corp.), and the family of U.S. Secretary of Education Betsy DeVos collectively contributed nearly 50 percent of the capital raised.

When in doubt, listen to employees. Legendary Silicon Valley lawyer Boris Feldman once told me that in his experience, employees are almost always good people who want to do the right thing, so boards can head off a lot of problems by meeting quarterly with them in the absence of management to simply listen to them. In the case of Theranos, those meetings might have been transformative for shareholders, despite the fact that the board members lacked expertise in blood testing. As set forth in *Bad Blood*, dozens of accomplished employees either resigned from Theranos or were terminated for raising ethical or technical concerns.

Whether you're an investor or prospective director, it pays to just keep it simple. If you come across a company that seems too good to be true, remember Theranos.