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Theranos: yet another lesson in good governance

Theranos, founded in 2003 by Stanford dropout Elizabeth Holmes burst onto the start-up media scene in around 2013 after raising $900 million (between 2004 and 2015) in funding from various prominent venture capital firms. She was mooted as "the next Steve Jobs" (probably due to her adoption of the black turtle neck as well as her role as a new Silicon Valley tech disrupter).

I've been following Elizabeth Holmes' downfall somewhat closely over the past few years. We humans are sardonically captivated by a fall from grace but I find it important to look past the stories and the media hype (and the obviously republished and reworded press releases espoused by mainstream media) and see what lessons can be derived from the tragedy and ensuring that both in investors and board members are armed with the knowledge to identify foul play if and when it occurs.

Holmes' rise to fame began in 2013 after claiming that her company, Theranos, had developed a new blood testing technology that could conduct a myriad of tests from little more than a pin-prick's worth of blood. This technology was intended to disrupt the $50 billion blood testing industry. However, hindsight would tell us that the enormous amount channelled into publicity and public relations, including overstated estimates for sales and new, innovative partnerships, was all part of the plan to raise the profile of the firm in order to source new investment to improve their technology.

The claim was that from a small amount of blood, Theranos technology could conduct around 200 experiments and about 90% of the tests which could be conducted in a standard laboratory. Theranos used this pitch to establish a partnership with US Pharmacist Walgreens, who provided Theranos with a $100 million "innovation fee" to fund the expansion.

Leading the search for new investment was Theranos President, Ramesh "Sunny" Balwani, who, along with Holmes, would provide potential investors with presentations which contained information about the products, development strategies, media clippings (raising the credibility of Theranos and Holmes) and sales projections. One notorious projection was that in 2014, Theranos would earn $100 million in sales. Again, with hindsight, its income was more like $100,000!

If one was to piece together the story behind this (which is pure speculation on my part) is that these 2014 projections were based on the premise of landing the US Department of Defence as a major client. The then retired general, Jim Mattis (now US Defence Secretary under the Trump Administration) and former Secretary of State and Diplomat Henry Kissinger had joined the Theranos board. This would've bought not only credibility in defence circles but also access to the senior echelons of the

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military and the Department of Defence. It's easy to see how Theranos technology would be valuable in military operations, as the ability to conduct blood tests in the field without having to send samples back to mobile laboratories would save time, money and lives.

These investment prospectus' also forecasted $1 billion in sales by 2015 (up from just $100 million in 2014). This 1000% increase in revenue must have raised some eyebrows during presentations but the money kept coming in to support the development of Theranos.

In 2015, the Wall Street Journal (WSJ) published an expose which questioned the validity of the statements made by Theranos.

In July 2016, the US Department for Medicare and Medicaid Services (CMS), following a long-running investigation, barred Theranos from operating any clinics following investigations into the firms laboratories in 2015. The letter sent to Theranos included a series of allegations of misconduct which indicated that laboratories operated by Theranos were comprised of "deficient practices [and] pose immediate jeopardy to patient health and safety." These allegations caused significant concerns for Walgreens who formally investigated the matter and severed ties with Theranos on the back of these allegations and the technical capabilities of their products.

At the end of 2016, Theranos, fighting off controversy and scandal, laid of 41% of staff due (340 employees) to its inability to secure further investment and the under-performance of sales.

Flanked left, right and centre from regulators, federal investigators, commercial partners and investors, Theranos, in dire financial straights (despite having cash in the bank from the days of fundraising) accepted a $100 million loan from Fortress Capital in December 2017 although experts claim this will only keep the company going for another 12 months.

As of March 2018, based on a Securities and Exchange Commission (SEC) investigation in California, Holmes, Theranos Founder and CEO, has being barred from serving on the board of a company for 10 years due to a "complex and long-running fraud" (according the Steve Peikin, Director of Enforcement for the SEC).

As with most meteoric rises, Theranos' downfall has been long and drawn-out. I was personally surprised to see Holmes retaining the helm despite the media, regulator and federal action taken against her and the companies board would have been wise to recommend her resignation and enacting a programme of consolidation and revitalisation (although this would have debatable impact under the current brand given the company's chequered history).

However, this article in Fortune is most pertinent to my summary of events. The board of Theranos was full of big-shots, military men and diplomats, the people who would help get you into your target industries using their networks and connections. However, as the article points out, none of those on the Theranos board had the required skills to oversee the affairs of a health-tech business valued at $9 billion.

Start-ups with significant growth ambitions, a high media profile and a strong reliance on investor capital to fund innovation and their go-to-market strategy will often line their boards with industry veterans, high flying executives and of course, Venture Capitalists (VC) and Private Equity (PE) with an interest in overseeing their investment and the achievement of forecasted targets. The board of Theranos in 2015, when allegations started emerging was as follows:

- Elizabeth Holmes - Chairwoman and CEO
- Henry Kissinger - Former Secretary of State
- Bill Perry - Former Secretary of Defense
- George Shultz - Former Secretary of State
- Sam Nunn - Former US Senator
- Bill Frist - Former US Senator
- Gary Roughead - Former Navy Admiral
- James Mattis - Former Marine Corps General
- Dick Kovacevich - Former CEO of Wells Fargo
- Riley Bechtel - Former CEO of Bechtel
- William Foege - Former Epidemiologist for the Centre for Disease Control (CDC)
- Sunny Balwani - President and Chief Operating Officer (COO)

There's a few things I'd like point out:

- This is a board laden with military expertise - one can only assume Theranos was aiming to expand their business through military might as opposed to business acumen. Many of these had no experience of running companies
- The boards reliance on politicians and ex-Secretaries of States suggests that Theranos was aiming at the highest levels of government to both generate sales and commercial partnership opportunities and build credibility.
- Limited clinical expertise - only Foege (Epidemiologist) and Frist (former Surgeon) could provide a clinical input to board proceedings. No pharmacists, pathologists or former regulators from the markets they were trying to enter.
- 11 men, average age of 80 - the narrative regarding the importance of diversity is prominent in today's board discussions. Even though Holmes was a prominent advocate of women's involvement in STEM (which is ironic when reviewing the make-up of her board)

Regardless of board oversight, it would be interesting to review the governance of Theranos. Specifically looking at the how the board responded to these allegations in a time of crisis with their limited expertise. The mass exodus of board members and executives around the time of a scandal often indicates that further difficult times were still ahead but to understand whether the governance structures in the organisation were operating effectively would be a recommended exercise. This would help identify gaps in corporate governance and lead to the better safeguarding of any future investment in the company.

As someone who advises organisations and boards on corporate governance, I feel that the start-up arena is relatively void of these expertise and rely more on publicity and over-inflated promises to raise private capital and my VCs, if they can't smell a rat, will happily do their due diligence and provide capital regardless of the structure of the organisation and the channels of assurance and accountability.

Theranos was once a unicorn in the start-up world, destined for the stars. Although, like Icarus, on the way to the stars it encountered the sun who, despite being warned of it's shortcomings, proceeded to have the wings melt and fall back down to earth. Companies on the rise (and their investors and shareholders) should ensure that this growth is built on firm foundations, including good governance, to ensure that a Theranos of the future avoids the same crisis bestowing on what was once a beacon of health and tech innovations.