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Investor and Entrepreneur Interest Alignment Challenges

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Dan Springer, CEO of Responsys, talks about the potential conflicts of interest between entrepreneurs and investors. Springer advises entrepreneurs to discuss these situations with venture investors in advance of making a deal so that all parties understand the potential outcomes upfront.

Transcript

One of the things that I frequently say is, you know, management's interest and investor interest aren't always aligned. They're most typically aligned when things are going really really well. And anything else, which is most companies, you often have difficulties, disagreements. I've raised venture money not as many times as you have, but once from a very prestigious firm and I found that our interests weren't always aligned and those are some tough conversations. Do you have any experience with differing interests and how to work out those differences? Yeah. So I have not yet, touch wood, had the situation where I've been in a bad business situation - where the investor group felt I was primarily on the hook and responsible for that bad situation. So I haven't had the very difficult challenges people can have where you're sort of breaking up with your venture investors and no one feels good about the piece of their pie, so to speak. But my sense, in terms of the discussions that you have, it's really important to think through those outcomes. And it's fun to sit around and say, I got X percent, they got X percent. When this is a three billion dollar company, this is how much I get, and how much founder share should I buy in advance, think about my AMT.

that's a fun kind of way to sit around and daydream. But I think it's really important that you go through and talk about the bad side and understand what's going to happen, what the expectations are on both sides if things don't work out. And the place where I think the, when things are a disaster, from a business standpoint, those really aren't that hard because there's no value. There's nothing to be carved up, everyone sort of goes their own way. Maybe there's a few last dollars and there's a discussion if you give that to employees, you pay back creditors. Very rarely do those VC's even want those last few dollars back. They've kind of written off the investment. The hard part is when you have a mediocre outcome. And people say no one has achieved what they wanted to achieve, but there's definitely a pie to be divided. And there's sometimes some real lack of understanding on early stage company builders on things like liquidity preferences, which is, when you have a liquidation event, how much of the money goes back to the investors before everyone gets there share.

So you might have a situation where you think you have 25 percent of a company you started, but if you took 20 million dollars of investment and 40 million dollars came out the back end, the venture investor has a 40 million dollar liquidity preference or two times their investment, you get zero because they get the first 40 million dollars. And those are the situations where I think you get in difficult places where you're considering an outcome like selling the company for 40 million dollars, but you say, "I worked really hard. If I sell this for 40 million dollars, you get all the money and get a reasonable return, and I get nothing. I'd like to renegotiate." Unfortunately, your leverage at that point is not very good. And at that point, when you're about to end a relationship, you sell the company, I think you'll find a lot of venture investors take their horizon to be much shorter. So they might be thinking about the long term relationship with you, but not very much. And they're more thinking about "I've got partners, I've got limited partners that I got to represent, and I got to get as much of this money as I can." But that's why I think it's worthwhile to have those conversations with people up front. And one place that I'm a little different than some people, a lot of people will tell you, make sure you get all the legalese document written. I prefer to take an approach where you have a frank conversation with the folks and just look them in the eye and say, "This is my understanding of how we're going to play things out if they don't go well. Are you comfortable with that? Is that the right principles?" And I don't think you'll find too many, if you're dealing with credible folks, that would then have amnesia on that conversation two years later.

Maybe you want a little email confirming it, but I'm less focused about trying to use a contractual enforcement with partners like that and more trying to go for the high moral ground, right? And have those discussions up front about what your goals are and how you're going to hang out with that.