Stanford eCorner

The Founder's Dilemmas [Entire Talk]

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Drawing on a decade of research and interviews with company founders, Harvard Business School Associate Professor Noam Wasserman explores many of the momentous early decisions and pitfalls faced by entrepreneurs and investors. Wasserman outlines paths and options for founders, with an emphasis on the frequently challenging people issues that can inhibit startup success.

Transcript

So here are founding team dilemmas. This is where we are assuming that the light bulb has gone off. You have evaluated it, you have gone through the thought process, hopefully avoided the passion becoming your downfall, the caution becoming the end of any of those aspirations and instead you have decided okay, now is the time to make that leap. A key early fork in the road, if not the first of the forks. We are going to take a look at where we are going to have very different ways that you can go in terms of the co-founder side. What do we think this option is? Go it alone? Solo founding? Be Superman, take the weight of the world onto your broad shoulders? Try to leap that building in a single bound all by yourself? Within my dataset even though this is a very valid choice if you have thought very clearly about whether you are what it takes to become a solo founder, only 16% of the ventures are solo founded. Far more the case that people head down the bottom path over here. 84% of them deciding to go the co-founding route. Just deciding to go down that path leads to a bunch of ripple decisions for you. We are going to take in particular a look at three of them, the three that my data have shown are particularly influential in terms of where the team is going to go.

We are going to call these the three Rs. There is going to be the relationships, the roles and decision-making and the rewards. What we are going to have is one slide on each of these and then going to go deep dive into the third of them. So first stepping back, looking at the relationships options, what do we think this decision is? Founding with friends, founding with the people that you have prior social relationships with, that you don't know in the professional realm. What's even more extreme than founding with friends? Founding with family. In my course we have a case on what we call the couple-preneurs. The significant others who are coming together to found. This is a very different model compared to co-founding with the people that you had prior professional relationships with. Key fork in the road on this relationship side of who am I going to tap as that source of co-founders? This, we are not going to have the time to go deeply into this but there are some critical pitfalls that you face along the way. Which one do we think is going to be more common of how people go with where they look for co-founders? Friends, how many people say friends is going to be? Friends or family? Okay, how many people say no? The other side of the ledger, the dream-team type? Interesting, the hands here happen to match what the data says.

And keep in mind, this is within tech ventures, within life sciences where you would expect a lower percentage of founding with friends and family than within small businesses and things like that and yet more than 50% of the teams in my dataset go with this left option, go with founding with the people that they know socially, but not professionally. So A, one thing is the preponderance of that decision. Which one of these decisions you think is a better one to go with? Which do you think is going to lead to a more stable team? Professional? Okay, people agree. Okay. This happens to be where we can see a very common theme throughout a bunch of these decisions. The most common of the decisions are the most fraught with peril. The social side teams, the friends and family, the data shows are the least stable of all the types of teams. They are the most likely to lose a founder sooner despite the glue that you would expect to be keeping them together. And so that most common of decisions, more than 50% of the ventures are leading themselves down a path of playing with fire, of having a decision that could lead to forging a stronger team and bringing them to the glory that they are seeking when they go and tap that source of co-founders but also is very likely when you are playing with fire to burn you. So now we are going to take the example that was raised and we are going to do a deep dive into that and contrast it with another team and their decisions.

This is going to be the Zipcar team, very prominent now, very well known. But this is back more than a decade ago when they were coming together as a team. Zipcar was founded by two women who knew each other socially. Their kids shared a day-care center, they lived near each other, they would have chats during drop-off and pickup time and were getting to know each other. One of the women had had a vacation to Europe and had seen a car-sharing service over there, liked it as a business idea. The two women also had a very laudable green streak, wanted to do something to help the environment here in the U.S and saw that that great business idea could also help, taking cars off the road, probably all sorts of additional implications for society here. And so they decided, hey, great idea. Let's go and co-found together. Let's go and build this car sharing company. One of the founders, Robin Chase, had heard a horror story from a friend of hers who had been in a start-up.

High potential idea that had gotten derailed by the equity split negotiation. This goes back to hearing the anecdote that leads you down a certain path. What do we think that Robin decided to do? Decided to make sure, hey, let's get this out of our way. Let's make sure that this isn't going to derail us in the same way. What do you think Robin proposed? One over N, the 50-50 split. She reached out, shook across the table, her co-founder agreed and Robin breathed a sigh of relief and said great, now the world is ours to go and conquer. We are off and running, we have gotten that out of the way. Over the next year and a half Robin threw herself into the venture, became the heart and soul of Zipcar, crafting every element of the business model, partnerships with the car companies, parking lot by parking lot, wrestling a parking space to go and put her car. Her co-founder didn't even quit her day job, contributing from the sidelines, barely doing anything at the level that Robin was. If we're Robin, how are we feeling right now? Resentful.

What? Resentful. Resentful. Okay, that kind of captures a little bit of it. I usually have to bleep out the first of the responses that people give me. When Robin came to class to talk about this, you could see the angst eating her up in her face. What she said at that point was that that was the stupidest handshake I had ever made. Who knows about all of the other elements, some of the things that have been highlighted about the uncertainties that we face, about commitment, about skill sets, about strategy, all of these pieces of it, that because we had a divergence from that best-case scenario that I was thinking about, I have had a year and a half worth of angst eating me up, that all of my hard work is going equally to my co-founder as it is to me. One of those perils of doing that early split, putting it in stone, thinking you have taken care of the problem, but it coming back to bite you. Let's go and contrast that to another team and the decisions that they made. There will be two key ways that this team made a different set of decisions.

This team is from the other end of the pie chart. This is the Ockham Technologies team. This was three prior co-workers, people who had worked together professionally, who were coming together to found. There are two key ways that they diverged from the Zipcar team. To me, the second one of them is the most critical. First, in terms of the first dimension, it was relatively obvious that they were not going to be contributing the same amount. One of the co-founders had worked for the other one. Seven years his junior. It was pretty evident one of them was going to be a much bigger contributor than the other one. So they sat down, they already honed the ability to go and have a real dialogue about these tension-filled issues, and they sat down and hammered out the first element of the difference from Zipcar's, the uneven split.

They ended up taking a cut at 50-30-20 as being their best estimate of where things were going to go in that long run. To me, the critical element is the second piece of it. What the Ockham team did was they zoomed in on their uncertainties. They zoomed in on a bunch of these key risks of what they didn't know or where things were going to go and in particular they took the highest ranking of those and did a deep dive into a dialogue about how that might change for the team and how it might cause the Robin Chase problem for them. In particular, the biggest uncertainty that they had was around the involvement of the idea guy, of Ken. They didn't know if Ken was going to be joining the team full-time. Ken had just become a first-time father as they were writing the business plan. Ken had never been a founder before. He had never been a father before. Are these two compatible with each other? And so he didn't know how he was going to grapple with that.

He also had a very nice job that he wasn't sure he was going to want to leave. And so they double-clicked on that set of uncertainties and went through three key scenarios that they did a deep dive into. When I was - this goes back to my computer engineering background, when I took a look at their founder agreement, I saw a series of if, then, else statements. They took the scenario that is the Robin Chase scenario, the best-case scenario, and said if Ken is on board full time, then this is what the equity split is going to be. Else, if Ken is on board only part time, the expected-case scenario, then this is what the split will be, else worst-case scenario, if Ken isn't on board at all, these are the buyout terms for us to reclaim his equity. That key element of going and tackling your biggest risks, your biggest uncertainties rather than avoiding them, rather than punting on them and also when we are looking at these scenarios, which is the natural scenario that, as founders, we go and focus on? Is it going to be the worst-case scenario? Is it going to be the expected-case scenario? The best-case scenario is the key one that we are going to be focusing on, which is very understandable. During those passionate early days when we are brimming with confidence, that's when we are going to be laying the plans that a Robin Chase does. She is going to be as committed as I am. We are going to be contributing our skills. We are all going to be lifting this heavy rock together as we go and try to pursue this.

That's the very natural inclination that we have to fight as founders. We have to also think hard and understand what are the expected-case scenarios, and the hardest of all, what are the potential pitfalls we are going to face? What are the potholes in the road that if we go and architect a very fragile agreement, like what Zipcar had done, when we have one of those potholes, is that fragile agreement going to shatter and come crashing down to earth? Going and tackling the highest of your risks, having that dialogue about how we can mitigate them, how we can go and architect ways to avoid the Robin Chase angst, as being a critical thing. But what also happens in the team when you start teeing up these types of high-tension issues? That's where you are starting to force a bunch of that interaction that will lead to a more productive founding team dynamic and ability to deal with those issues. The equity split is only going to be the first of the high-tension issues that you are going to be facing together. Going and honing it, going and using a whole bunch of these things that we usually would likely avoid, is a way for us to be able to hone the relationship within the team, build the trust and be able to go forward when we hit more bumps in the road because we haven't just punted on those. What's the worst-case scenario if you are not compatible with your co-founder? What is the worst-case scenario about when you are going to find that out? Too late. Way down the road. Far better, we talk about fast fail with products, far better for you to not do the punting that Robin Chase did, far better to tee up those high-tension issues early on and learn then that you are not compatible, that you are not going to be on the same page about these things, rather than going down the road and finding out way at the end of this initial stage that you are in together. And so all sorts of benefits that come from forcing yourself to look at those other scenarios and for being able to see that the uncertainties that we face, we should be matching them with dynamism in our agreements, in our expectations, in the things that we are putting in place early on as a team. And so that dynamic element, having that match our uncertainties as being a key thing that the Ockham team was doing and that Robin Chase very naturally avoided because of looking at that rosy scenario during those early passionate days.

So I am going to start out with a happy topic, that topic being failure, entrepreneurial failure in particular. This is something that we all hear about, something that is an amorphous fact of life, that we just have to take as a given, that a very high percentage of startups are going to fail. And so in between all of the wringing of the hands, all of the dreading that this might be the future of what we are heading towards, I happened to run into an article that was written 25 years ago. From what I understand it's actually the only other HBS professor who has come to ETL and has visited and talked about his research. This was not what he would have talked about. This is what - it was not at all a focus of his at the time, but it was a professor named Bill Solomon. And Bill was going in, back then, to try to go and explore inside a black box. That black box being venture capital. What are venture capitalists do? What does their job entail? Going into all of the different dimensions of it, how do they go and get deal flow? How do they go and assess investments? How do they do due diligence? How do they negotiate term sheets? Once they have negotiated and made the investment, what do they do when they come onboard? And so Bill was understanding all of these different dimensions of venture capital and what do venture capitalists do. Fortunately, along the way he also thought to ask them what was a very small part of his paper, but was a critical question for me, that when I saw this one line and this one data point within his paper, it hit me like a ton of bricks that this is where I should then devote the last dozen years of my life.

So a high-impact one line and one data point. What he went and asked them about was about the parts of their portfolio that we would never hear about. The parts of their portfolio that they would never issue press releases bragging about how they had done, that they would not be posting them these days on their websites. That happens to be the parts of their portfolio that failed. Tell us about the startups that you thought were so high potential that you invested in them, but then they ended up on the dustbin of history. What are the reasons that they failed? And Bill went in with his ideas and same kind of things that I would have gone in with, of thinking about what that list would look like. What are the leading reasons for failure of these high-potential startups? And what he found was, lo and behold, about 35% of the reasons for failure were those things that we would have thought about, what today we would call product/market fit problems or issues within functions as you are trying to develop your product and then once you have it developed as you are trying to go tackle the customers, get them to pay, support them, all of these other functional reasons, those were indeed a little bit more than a third of all of the reasons for failure. There was, though, one predominant reason for why these high-potential ventures had failed. That potential failure reason was 65%. They were the people problems.

The interpersonal tensions between the founders as things are getting off the ground, or the tensions between them and the hires who were brought in to complement them, or the other people who were getting involved as you are trying to build your high-potential venture, you are trying to pursue that opportunity and bringing all of these other pieces on board. The board. The board of directors. Is that an important decision-making body? Is that something with important implications for roles and decision-making as you are looking at them overseeing all of these key decisions within the company? What are some of those most important of decisions that you would have given up here? Acquiring or evaluating the founders and CEOs.

Okay. So for the founder, as the founder CEO you now have someone who is evaluating you. Someone who is deciding whether you are going to be able to stay in that CEO seat. Control of the board. Control of the board. Okay, what are some of the other decisions that they would be controlling then? Who gets hired as the new CEO.

Okay, who gets hired potentially as your replacement. Is this an easy thing for a founder to get this message? No. No, why not? It's never easy for anyone to get this message. Is it harder for a founder than for others? Sure. Why? It's your baby. Your baby. That's a pretty deep level of attachment here. I was the parent. I am getting fired as the parent of the baby. You get to decide who the adoptive parent is going to be.

This is at that heart level of the founder grappling with it. Let's go to one founder who has actually been to ETL recently. Jack Dorsey talking about when he heard that message when he was being fired as the founder CEO of Twitter. The punch in the stomach, the ton of bricks hitting you, a very visceral reaction that founders have to this message they are getting fired as the parent of your baby. Is Jack the only one who has faced this? Is this a common thing that we face within this realm? Well let's go to the data. This is my data on, from founding, the percentage of founders who are still CEO. And then this is as the venture plays out and ages over time. Halfway across, a little bit more than four years old, half of the founders have been replaced as CEO. Do we think that the norm would be that a founder is raising his hand and volunteering to be replaced? 73% of these have been firings. 73% were where the board was initiating it rather than the founder saying I can see where things are going, I can understand that roadmap and I think that there is going to be someone better to be taking my place.

So far more the case that you are getting blindsided by this very visceral message that you are no longer going to be the right person to parent this baby. Key things to think about as you are going in and involving those investors. At the C round when ventures have raised their third round of financing, at that point 52% of the founders have been replaced. Each round that you raise heightens the chances and also some key inflection points that change the challenges within the venture leading to a heightened chance that you are going to get replaced as that CEO of your baby. So how do we step back and see that fork in the road, very visceral reaction for the founder. How do we think the rest of the team, the loyal employees that that founder has brought together, is going to be reacting if fearless leader is really ticked off in having this visceral reaction to being replaced? What is that going to mean for the team? Are they all on board with this? Morale issues, potential turnover issues, all sorts of challenges. As they are bringing in a successor, is that going to be a recipe for glory? This goes back to one of the other things that heightens the chances of the founder being replaced. You complete product development, critical milestone within the venture. What happens when a venture finishes product development? What do they do? They celebrate. They throw a party.

It's a critical milestone. The main thing that we have been pushing towards and we have achieved it now. The other side of what we talked about, you raised each round of financing. What's the first thing that the founders do with the investor's money? Throw a party. You raise more money, throw a bigger party. What are they celebrating? They actually happen to be celebrating a heightened chance, the data shows, of fearless leader being replaced. It's what I call the paradox of entrepreneurial success. Your success has bred your demise. If we think about the founder who is failing as CEO, getting that Donald Trump message that we have to replace you, how is that founder going to react? There is going to be some of the visceral side but the head would be saying yes, this is a necessary change. When that founder has been succeeding at leading product development and getting the stamp of approval from investors, is that founder going to be more or less receptive to being replaced as CEO? That's the last person who is going to be open to that message, who is going to be able to hear that.

So those successful founders are the ones who are breeding their demise even sooner by sparking that fast growth that outgrows their skills and a lot of times at being on that rocket fuel that they raise as they were inviting those investors into the board.