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THE FOUNDER'S DILEMMAS

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THE FOUNDER'S DILEMMAS

ANTICIPATING AND
AVOIDING THE PITFALLS
THAT CAN SINK
A STARTUP

NOAM WASSERMAN

PRINCETON UNIVERSITY PRESS | PRINCETON & OXFORD

Copyright © 2012 by Princeton University Press
Published by Princeton University Press,
41 William Street, Princeton, New Jersey 08540

In the United Kingdom: Princeton University Press,
6 Oxford Street, Woodstock, Oxfordshire OX20 1TW

press.princeton.edu

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Library of Congress Cataloging-in-Publication Data

Wasserman, Noam, 1969–

The founder's dilemmas : anticipating and avoiding the pitfalls that can sink a startup /
Noam Wasserman.

p. cm. — (The Kauffman foundation series on innovation and entrepreneurship)

Includes bibliographical references and index.

ISBN 978-0-691-14913-4 (hardcover)

1. New business enterprises—Management. 2. Entrepreneurship. I. Title.

HD62.5.W375 2012

658.1'1—dc23

2011037954

British Library Cataloging-in-Publication Data is available

Published in collaboration with the Ewing Marion Kauffman Foundation and the Berkley
Center for Entrepreneurial Studies, New York University

This book has been composed in Sabon and Trade Gothic

Printed on acid-free paper. ∞

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1

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PART I
INTRODUCTION AND
PRE-FOUNDING



CHAPTER ONE

INTRODUCTION

IT'S UNFORTUNATE BUT TRUE: IF ENTREPRENEURSHIP IS A BATTLE, most casualties stem from friendly fire or self-inflicted wounds. Some four decades ago, sociologist Arthur Stinchcombe attributed much of the “liability of newness”—the particularly high failure rate of new organizations—to problems within a startup’s founding team. More recently, venture capitalists in one survey attributed 65% of failures within their portfolio companies to problems within the startup’s management team.¹ Another study asked investors to identify problems they thought might occur within their portfolio companies; a full 61% of such problems involved issues within the team.²

Researchers have extensively studied the failure rates highlighted by Stinchcombe. Unfortunately, they have focused almost entirely on external causes rather than on the more numerous internal problems Stinchcombe identified.* We know amazingly little about the chief perils that beset the entrepreneurial activity we so often acclaim as the very heart and soul of the economy. As researcher Amar Bhide put it, “Entrepreneurs who start and build new businesses are more celebrated than studied.”³

* In a classic two-page discourse, Stinchcombe (1965) argued that the liability of newness was due to three internal factors—the needs for the team to develop working relationships, to find their new roles, and to split financial rewards among themselves—and one external factor—the lack of relationships with potential suppliers, customers, and other external parties. The last factor has received vast amounts of attention, the first three very little.

This book scrutinizes those all-important “people problems” that bedevil all founders—even solo founders—and their startups.* These problems often follow predictably from common dilemmas faced by any startup as it grows and evolves—what I call “founding dilemmas.” One such dilemma recurs throughout the stages of company development: The need to negotiate a trade-off between wealth and control, between building financial value and maintaining a grip on the steering wheel. Adding further complexity, founders’ early choices can have delayed and unexpected but significant effects,⁴ sometimes because natural inclinations such as passion, optimism, and conflict avoidance lead to shortsighted decisions. This book delves into the challenges faced or created by each of the main groups of players involved in a typical startup, beginning with the core founder and moving on to his or her cofounders, early hires, and investors.

I’ve spent over a decade working with hundreds of founders and future founders, and I’ve collected and analyzed data on nearly 10,000 founders in the technology and life sciences industries. This book will draw on my unique dataset, and we will also follow actual founders as they launch new companies and struggle with dilemmas identified in my research. Most centrally, we explore the experience of Evan Williams, a young entrepreneur who moved from rural Nebraska to the San Francisco area in the mid-1990s, hoping to catch the wave of the Internet boom after working on a failed startup back home. A self-taught Web designer and programmer, Evan recognized the potential of Internet applications, particularly in the exploding area of self-publishing, and created Blogger, one of the first and most popular blogging tools. Later, Evan developed an early podcasting idea, Odeo, which he believed would enable nontechnical people to produce, publish, and share audio content, much as Blogger had done for millions of ordinary people with the written word.

In both startups, and then later when he went on to found and lead Twitter before leaving to work on yet another startup, Evan faced key *dilemmas*—difficult decisions at important forks in the

* This is not to say that choice of strategy, business model, and industry segment are not important. We will indeed consider the effects of those choices when appropriate.

road of his entrepreneurial journey—and took steps that would shape the startup’s future, affect its value, and help determine his degree of control over it. With Blogger, Evan chose to cofound with his former girlfriend, fighting to retain for himself the CEO title and a majority of the equity. He funded the company using his own money along with money from friends, family, and angel investors, intentionally avoiding venture capitalists (VCs). He hired friends (and later, volunteers) to inexpensively develop the technology. When the dot-com boom ended and Blogger ran low on cash, he received an acquisition offer but refused to sell—a decision that would send his cofounder and his entire staff fleeing for the exits and reduce him to soliciting donations to keep Blogger alive.

Evan eventually sold Blogger to Google and turned next to developing Odeo, partnering with an acquaintance who had experience in online audio. Using some of his proceeds from Blogger, Evan seeded Odeo and let his cofounder take the CEO role. As Evan realized the huge potential for podcasting, he took over as CEO and raised \$5 million from VCs, who stepped in to help make significant decisions. With the VC money, Evan hired an experienced and expensive leadership team, hoping to develop Odeo quickly enough to stay ahead of foreseeable and formidable competitors such as Apple and Yahoo.

Evan holds particular interest for us because his very different approaches to founding and running Blogger and Odeo highlight the wide variety of options available to founders. Evan’s decisions may seem wildly inconsistent: He takes VC funding in one case and vehemently resists it in another. He hires his pals for next to nothing in one case and pays big bucks for the pros in another. He battles his own ex-girlfriend for the CEO role and finally squeezes her out of the company but then readily turns the reins over to a mere acquaintance in his second startup. Going deep into Evan’s story, we will explore both the underlying consistency of his decisions and the powerful motivations and situational factors at work, an exercise that will enable current or would-be founders and others involved in startups to unlock the mystery of their own motivations and dilemmas as they enter the battle that is entrepreneurship.

CORE CONCEPTS AND ARGUMENTS

Founding a startup can seem like a fragmented, even chaotic, way of life. Perhaps no business pursuit is messier than creating an organization from scratch. Founders themselves are an extremely varied group, and academic research on entrepreneurs is fragmented, with different researchers looking at different stages of the founding process, turning different disciplinary or functional lenses on the issues they study, and developing findings with little apparent consistency. Meant for entrepreneurial scholars, educators, and mentors of entrepreneurs as well as entrepreneurs themselves, *The Founder's Dilemmas* highlights the consistent, coherent, and systematic patterns and trade-offs involved in the most critical founding decisions, from the dreamer's decision of whether or not to found in the first place through the founder's decision to exit the company he or she has created.

Before we can get started, we must define some core concepts and arguments. I focus the discussion on the founding of *high-potential startups*; that is, startups (often technology- or science-based) with the potential to become large and valuable, even though their founders may subsequently make decisions that limit their growth. Where necessary, I integrate relevant findings from research on high-potential startups with the larger literature on founding small businesses, careful to note differences between the founding of high-potential startups and the founding of small businesses that are designed to remain small and owner-operated.*

Founders, as I speak of them, are individuals who start new organizations to pursue opportunities, as scholar Howard Stevenson put

* Carland et al. (1984:354) state, "[A]lthough there is overlap between entrepreneurial firms and small business firms, they are different entities." Aldrich et al. (2006) differentiate between the small businesses on which they focus and "high technology" startups, such as those studied in the Stanford Project on Emerging Companies (SPEC). Yet, many of SPEC's startups were outside traditional "technology" industries, as is the case with the life sciences startups in my dataset, necessitating the use of a broader term for such organizations. (Thus, I use "high-potential startups.") Schumpeter (1934) provides us with another way to differentiate between small businesses and "entrepreneurial" businesses. He characterizes new entrepreneurial businesses as being geared toward introducing new goods, introducing new methods of production, opening new markets, and/or opening new supply sources. See Carland et al. (1984) for further discussion of these characteristics and differences.

it, “without regard to the resources they currently control.”⁵ They make the early decisions that shape the startup and its growth, an influence that begins even before the founding itself and that can extend through all stages of the startup’s development.* This book’s central message is that these founding decisions need to be made *by design*, not by default. Each decision requires the founder to assess multiple options; there are more critical decisions—and more options within each decision—than many founders realize. Often, the “right” decision is by no means obvious, and may even be counter-intuitive. In addition, it can come with a burdensome cost, making the decision gut-wrenching and requiring the founder to face stark trade-offs. Meanwhile, the most common decisions—cofounding with friends, splitting equity equally among cofounders, etc.—are often the most fraught with peril. That’s why I refer to the decisions discussed in this book as *dilemmas*. Founders who feel they have gained everything and lost nothing by an early decision that felt like a no-brainer may be in for a nasty surprise later on, when they find out what trade-off they should actually have been considering.

The major parts of *The Founder’s Dilemmas* explore the dilemmas founders face by progressively introducing new players whose involvement in a startup provokes difficult decisions that significantly affect the startup’s direction and outcomes. We begin with the core founder, then add cofounders, and end with hires and investors. In each unfolding part, we examine the impact of these players on the startup’s outcomes—most centrally, on the stability of the founding team, the valuation of the startup, and the founders’ abilities to keep control of the board of directors and the CEO position. An appendix to Chapter 11 also delves into exit dilemmas, which come long after founding but are faced by founders lucky enough to make it to that point, and which involve many of the same underlying factors.

The primary founding dilemmas we’ll explore, and the questions a potential founder should ask about them, break down into the following:

* Stevenson’s definition of entrepreneurship has also been applied to people who did not start their organizations but are “acting entrepreneurially” in building those organizations. In contrast, “founders” are the people who *start* their organizations.

1. **Pre-founding: Career Dilemmas**—When in my career should I launch a startup? If I am passionate about an idea, but haven't accumulated the right career experiences yet, or the market is not yet receptive to my idea, or my personal situation is unfavorable, should I make the leap anyway?
2. **Founding Team Dilemmas**—Deciding to launch a startup introduces many more dilemmas regarding the startup's founders.
 - a. **The Solo-versus-Team Dilemma**—Should I launch the business myself or try to attract cofounders?
 - b. **Relationship Dilemmas**—Whom should I try to attract as cofounders: Friends? Family? Acquaintances? Strangers? Prior coworkers?
 - c. **Role Dilemmas**—What positions should each of us take within the startup? Which decisions can we make alone, and which should we make as a team? How should we make those decisions?
 - d. **Reward Dilemmas**—How should we divide equity and other financial rewards among the founding team?
3. **Beyond the Founding Team**—Both the startup's growth and lingering gaps in the founding team's abilities or resources often require founders to consider adding nonfounders and their resources. This introduces further dilemmas.
 - a. **Hiring Dilemmas**—What types of people should I hire at different stages of growth? What challenges will my early hires face as the startup grows? Should I compensate early hires differently from later hires?
 - b. **Investor Dilemmas**—What types of investors should I target at different stages of growth? What challenges will these investors introduce?
 - c. **Founder-CEO Succession**—Why and how are founders replaced as CEOs of the startups they founded? How can founders exert more control over the process? What happens to the founder and to the startup after he or she is replaced by a hired "professional CEO"?

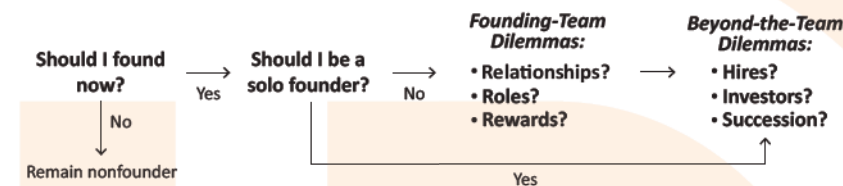


Figure 1.1. Sequence of Founding Dilemmas

Figure 1.1 is a high-level summary of these dilemmas and a road-map to which we will return regularly.

These dilemmas do not necessarily occur in the clear sequence implied by the book’s structure. The founding process is often chaotic and nonlinear,⁶ with founders improvising rather than following a script to build their startups.⁷ For example, core founders often get an idea—the proverbial light bulb goes off—and then face the question of whether to pursue it alone or attract cofounders. This is the “idea-then-team” approach to building a startup, exemplified in this book by Tim Westergren (of Pandora Radio) and others. But it can also happen that a team decides to work together on a startup, *then* hunts for an idea. This is the “team-then-idea” approach, exemplified by Janet Kraus and Kathy Sherbrooke, who met at Stanford Business School, formed a close working relationship through joint leadership roles, and decided that they would eventually try to find an idea with which to found a company. That startup later became the corporate-concierge company Circles. Given such differences in sequence, I’ve written this book so that people who want to learn about founding dilemmas in sequence can read the chapters in order while people interested in specific dilemmas can go straight to the chapters that most interest them.

More important than the sequence is what the dilemmas have in common: They are all difficult but necessary decision points, each with a number of often-unrecognized options that, in turn, have important consequences for the founder(s) and the startup. They each call for careful and rational decision making—sometimes by a lone founder and sometimes by a founding team. Finally, the dilemmas examined in this book all hold in common their tendency to manifest the following three major themes.

Short-term versus Long-term Consequences

An “easy” short-term decision may introduce long-term problems; a “hard” short-term decision may often be best in the long run. *Conflict avoidance* often leads founders to make easy short-term decisions; they succumb to the temptation to sidestep or postpone acknowledging—not to mention resolving—these dilemmas, especially if coming to a decision would require difficult conversations about what could go wrong. Let’s suppose you have started a company and made your brother the chief financial officer, as did one of the founders we will study. What if your brother turns out not to be very good at it? The only thing more awkward and awful than talking about that in advance would be dealing with it once it’s happening. Founding a startup is akin to a wedding, a declaration of mutual devotion. It seems inappropriate and even counterproductive to plan for a breakup, yet in entrepreneurship, failing to make the pre-nup part of the wedding vows, so to speak, can prove disastrous.

To make matters worse, entrepreneurs usually find it much harder and more costly to undo an early founding mistake than to make the right decision to begin with. Sequences of decisions are also often *path dependent*; early decisions tend to close off future options that the founder would otherwise have regarded as attractive. We will examine costly mistakes that should be avoided and, where possible, explore ways to undo such mistakes.

Members of the entrepreneurial community often say that the founding process is “a marathon made up of a series of 100-yard dashes.” Every 100 yards, the runner/founder faces a key decision with long-term consequences. Unless you have a clear picture of the path to the finish line, decisions made during any specific dash can throw you off course or put you out of the race altogether.

Natural Biases: The Perils of Passion, Optimism, and Instinct

Founders tend to pride themselves on being action-oriented and optimistic—necessary traits, indeed. A founder’s passion is essential to launching a startup, but it can become deadly at almost every step.

Likewise, founders' natural biases—toward optimism over realism, toward instinct over systematic planning, toward strong attachment to their ideas, their startups, and their employees over dispassionate reasoning—often turn on them.

Take optimism. Excessive confidence and optimism in the startup's prospects can lead entrepreneurs to involve family and friends both as employees and as investors, imperiling both the relationships and the startup. Optimism leads founders to make overly rosy predictions about their own chances of success in comparison to their competitors' chances,⁸ to overestimate their own abilities and knowledge,⁹ to underestimate their initial resource requirements, and to fail to plan for foreseeable problems. As a result, founders often fail to attract the resources they will actually need, increasing their chances of failure.¹⁰ Too much hubris, confidence, and passion can hinder a founder from exploring alternative approaches and making necessary adjustments.¹¹ In addition, the entrepreneurial environment itself can exacerbate a founder's vulnerability to his or her own overconfidence. Many entrepreneurs work in highly uncertain and "noisy" environments in which feedback is ambiguous and based on uncertain evidence. Such environments render people especially susceptible to cognitive biases and errors, including overconfidence,¹² and to following their instincts, the one "input" that does seem clear.

As we will find in each chapter, founders need to see past their instincts and their natural propensity for wishful thinking to grasp the full range of options and consequences. They need to expect the best while preparing for the worst and to make decisions strategically rather than reactively. Founders may repeatedly find that simply following their instincts will prevent them from thinking hard enough about their decisions and the consequences of particular paths of action.

Divergences among Can, Do, and Should

Thanks to conflict avoidance, path dependence, natural biases, and ignorance of the long-term consequences of their decisions, founders often take actions that diverge considerably from what they *should*

do. In each chapter, we will explore the range of available options (what founders *can* do) and how often founders choose each option (what they *do*). Whenever possible, we will examine how decisions affect important outcomes, such as the startup's growth, the founding team's stability, and the founder's long-term control; this will offer insight into what founders *should* do. Each chapter will close with prescriptive recommendations: how founders can make better decisions.

First-time founders will likely not know about the dilemmas we will examine. They may not understand the full range of options available to them, and they may not appreciate their decisions' long-term and often cumulative consequences. (They may not even realize they are making an important decision!) But even experienced founders can blunder, especially if their experience has afforded a vivid but limited picture of the founding dilemmas.

WEALTH VERSUS CONTROL: A CLOSER LOOK

Now that we've introduced the key concepts and arguments relating to founders' dilemmas, let's probe deeper into the most common and difficult dilemma of them all. Founders may misunderstand not only the rules and moves of the game, but also their goals in playing it. Many admire founders who built and still run their companies, startup founders who became rich and powerful CEOs. They remember Bill Gates, the geeky teenager who became the fearsome CEO of one of the world's biggest and most aggressive companies, not to mention the world's richest person. Yet it is the rare founder who achieves this "entrepreneurial ideal" of building a business, running it, and getting rich from it. In fact, a dirty little secret of entrepreneurship is that many decisions along the entrepreneurial journey—even unquestionably "right" decisions—tend to push that ideal a little farther out of reach by forcing the founder to choose between building the company's value and maintaining his or her own control over it.* Evan Williams faced these trade-offs with each

* Parts of this trade-off have parallels in at least two other academic literatures. First, the finance literature has looked at the "private benefits of control," using such measures as

step he took building Blogger and Odeo. The very different decisions he made in each case brought about very different outcomes precisely because he had struck different trade-offs.

Although the desires for wealth and control seem complementary, as entrepreneurial motivations they turn out to exist in perpetual tension with one another. This counterintuitive clash results from the central challenge entrepreneurs face—the “resource-dependence” challenge.¹³ Founders need to attract outside resources—people, information, and money—in order to pursue opportunities and build the greatest value.¹⁴ But acquiring these resources typically requires that founders cede more and more control. Cofounders and key employees want equity. Skilled and experienced employees want to call some of their own shots. Investors want to protect their investments, typically by means of a strong presence on the startup’s board and by other terms of the deal structure.

With a wide range of possible options, how can entrepreneurs choose the best one? The key is to know what they want to accomplish with any given decision. Similarly, when founders must choose over and over again between profiting from their hard work and keeping control of their own creation, the best way for them to know what to do is to know their own motivations—why are they there in the first place? An individual’s motivations are almost always complex and rarely transparent to anyone—including the individual himself or herself. Still, research shows that founders’ two most common motivations are (a) building wealth and (b) driving and controlling the growth of their startups.¹⁵ Founders who consistently make decisions that build wealth are more likely to achieve what I call a “Rich” outcome (greater financial gains, lesser control), while founders who consistently make decisions that enable them to

the difference in the prices of securities that are identical except for their voting rights, and found that people are willing to give up economic gains to gain control or voting rights (e.g., Grossman et al., 1988; Lease et al., 1983). Second, the negotiations literature (e.g., Walton et al., 1965) has examined some elements of the theoretical tension between value claiming and value creation.

maintain control of the startup are more likely to achieve what I call a “King” outcome (greater control, lesser financial gains).*

Multiple studies have confirmed that these two motivations are the most common. In the Kauffman Foundation’s study of 549 founders of American technology startups, 75% of the respondents said that building wealth was a very important motivation for becoming an entrepreneur and 64% said the same of wanting to own their own businesses.¹⁶ Likewise, the Panel Study of Entrepreneurial Dynamics asked 1,214 respondents about their motives for starting a business. The top six motivations were control motivations, such as freedom to take one’s own approach to work and fulfilling a personal vision, and wealth-building motivations, such as gaining financial security and building great wealth.¹⁷ The CareerLeader database, which includes more than 2,000 entrepreneurs (and 27,000 executives in total) worldwide, found that for male entrepreneurs in their 20s and 30s, the top four motivators all amounted to forms of control or wealth gain.[†] Other motivations, such as intellectual challenge, altruism, and prestige, can prove important, but across entrepreneurs as a whole, wealth and control compose the big two, and are also the two that repeatedly come into conflict with each other.[‡]

A founder who knows whether wealth or control is his or her primary motivation will have an easier time making decisions and can make *consistent* decisions that increase the chances of reaching

* This is one of the areas in which owner-operated small businesses differ significantly from high-potential startups, which require significant resources to reach their full potential.

† The very extensive CareerLeader survey, which was developed by psychologists and psychometricians Dr. Tim Butler and Dr. James Waldroop, also evaluates a person’s core interests, the kind of organizational culture he or she most enjoys and succeeds in, his or her strengths and weaknesses, and the characteristics that may limit his or her success. Chapter 2 lists the 13 potential motivators and details the breakdown of motivators by entrepreneur/non-entrepreneur, gender, and age group.

‡ Founders often talk broadly about starting a business because they want to “have an impact.” Yet what they mean by “impact” can vary widely. Control-motivated founders might dream of bringing to market a product that fully realizes their uncompromised vision, even if it means that fewer people will buy it. Wealth-motivated founders might dream of getting a product into as many hands as possible, even if the founder wound up having little influence over the product’s characteristics and features. Diverging ideas about impact can—and should—lead founders to make very different decisions and take very different actions.

the desired outcome—Rich or King. Figure 1.2 summarizes the core wealth-versus-control dilemmas we will examine throughout Parts II and III and that we will revisit in the book’s concluding chapter. (In Chapter 11, we will also explore the potential advantages and risks of making deliberately inconsistent decisions and of trying to maximize both wealth and control.) Yet the motivations themselves do not necessarily remain fixed. Founders must also watch for changes in their own motivations; we will consider the factors that cause such changes and how they should affect a founder’s subsequent decisions.

UNSOLVED PUZZLES

One test of any new framework or model is whether it can explain unanswered questions or unsolved “puzzles.” This book will tackle puzzles about entrepreneurs, including the puzzle of “the missing private-equity premium” and the notion that founders aren’t as powerful within their companies as we commonly assume.

Most economists assume that entrepreneurs are out to make a lot of money. According to one researcher, “That the entrepreneur aims at maximizing his profits is one of the most fundamental assumptions of economic theory.”¹⁸ One recent study supports the notion that entrepreneurs want to build personal wealth by owning equity in a valuable startup,¹⁹ finding that many founders of high-technology startups believe they stand a much greater chance of becoming wealthy by launching a startup than by ordinary employment.²⁰

If many founders really do believe this, it appears they are largely wrong. On average, entrepreneurs earn no more by founding startups than they would have earned by investing in public equity—less, in fact, from a risk-return perspective.²¹ One large study of startups suggested that, on average, it would not make sense for potential entrepreneurs with a normal amount of risk aversion and a moderate amount of savings to become founders of venture-backed startups.²² Likewise, for the self-employed, initial earnings are lower and earnings growth significantly slower than for those engaged in paid

<i>Potential Participants in the Startup</i>	<i>Decision Area</i>	<i>Decisions Oriented toward Maintaining Control</i>	<i>Decisions Oriented toward Maximizing Wealth</i>
Cofounders	Solo vs. team	Remain solo founder (or attract weak cofounders)	Build founding team; attract best cofounders
	Relationships	First look to immediate circle for “comfortable” cofounders	Tap strong and weak ties to find the best (and complementary) cofounders
	Roles	Keep strong control of decision making; build hierarchy	Give decision-making control to cofounders with expertise in specific areas
	Rewards	Maintain most or all equity ownership	Share equity to attract and/or motivate cofounders
Hires	Relationships	Hire within close personal network (friends, family, and others) as required	Aggressively tap broader network (unfamiliar candidates) to find the best hires
	Roles	Keep control of key decisions	Delegate decision making to appropriate expert
	Rewards	Hire less expensive junior employees	Hire experienced employees and incent them with cash and equity
Investors	Self-fund vs. take outside capital	Self-fund; “bootstrap”	Take outside capital
	Sources of capital	Friends and family or money-only angels; tap alternative sources (e.g., customer prepayments or debt) if possible	Target experienced angels or venture capitalists

Terms	Resist investor-friendly terms (e.g., refuse any supermajority rights) Avoid building official board; when built, control composition and makeup	Be open to terms necessary to attract best investors (e.g., supermajority rights) Be open to losing control of board if necessary to get best investors and directors
Board of directors		
Successors	Trigger of succession	Be open to initiating succession when next stage of startup is outside one's own expertise Be open to giving up CEO position to better CEO Want to remain executive in position that matches skills and preferences
Openness to succession	Resist giving up the CEO position	
Desired role after succession	Prefer to leave than to remain "prince"	
Other factors	Preferred rate of startup growth Capital intensity Core founder's "capitals"	Fast to explosive High capital intensity Important gaps that should be filled by involving others
Most likely outcome	Maintain control; build less value	Build financial value; imperil control

Figure 1.2. Wealth-versus-Control Dilemmas

employment, a finding that has been confirmed in a variety of industries and using a variety of earnings metrics.²³ All told, entrepreneurs earned 35% less over a 10-year period than they could have earned in a “paid job.”²⁴ The authors of these studies therefore wondered why so many intelligent people would wish to play this game if there is indeed no “private-equity premium.”²⁵ In Chapters 2 through 10, we will find pieces of the answer, while Chapter 11 offers a comprehensive answer: Founders face decision after decision in which they must choose between increasing their wealth and maintaining control. Founders who choose to remain King should indeed end up less Rich.

Turning to the question of founder power, academic studies have assumed that the founder of a startup—the person who conceived the idea and assembled the people and resources—looms as a powerful person within that startup.* How could the “revered founder” not be?²⁶ Yet once again, the evidence described here belies a fundamental assumption. My quantitative research found that a high percentage of founder-CEOs are replaced as CEO, most often against their wills.²⁷ The public thinks of business eminences such as Bill Gates, Richard Branson, Anita Roddick, and Michael Dell—wealthy and powerful CEOs of the companies they created—but these are the very rare exceptions. Far more common is the founder-CEO who is replaced before his or her startup gets anywhere near the public markets. How can we explain this? And why is it that founders receive, on average, significantly *lower* compensation than nonfounders?²⁸ Again, these seemingly puzzling facts will make sense by the time we revisit them in Chapter 11.

In much of the academic literature, wealth and power go hand in hand. In C. Wright Mills’s classic analysis of the “power elite,” for instance, the corporate power and economic wealth of top executives reinforce each other, with corporate positions serving as

* For instance, in his seminal study of the dimensions of executive power, Finkelstein (1992:509) posits that founders not only are powerful figures within the startup team itself, but “may gain power through their often long-term interaction with the board, as they translate their unique positions to implicit control over board members.” The power of the founder is assumed to be so strong that it even enhances the power of the founder’s relatives who are involved in the startup.

the source of wealth while “money provides power.”²⁹ However, my research has found that wealth and power are decoupled for entrepreneurs and, indeed, in active conflict. As a result, few founders of high-potential startups can achieve both wealth and power; most choose between one or the other and often end up with neither. Even a seemingly reasonable strategy for achieving high levels of both wealth and power, rather than maximizing one over the other, is actually more likely to put them both out of reach. We will see why this frustrating condition occurs.

10,000 FOUNDERS STRONG

To paint a rich but rigorous picture of the most important decisions made by founders and the outcomes that founders experience, *The Founder's Dilemmas* marries deep case studies with analyses of a unique large-scale database.* Given the lack of comprehensive public data sources about startups, I collected my own data from across the United States by performing annual surveys of private high-potential startups. The survey included questions about each startup's founders, nonfounding executives, compensation and equity holdings, financing history, board of directors, and other dimensions of organizational life. I conducted these surveys for 10 consecutive years, from 2000 through 2009, creating a unique dataset that includes 9,900 founders—and more than 19,000 executives in total—from 3,607 startups. These data are more representative of high-potential startups in the United States than any other dataset of comparable size and richness. The decade covered in the surveys spanned all stages of the business cycle, from the heights of exuberance in Internet startups to the depths of despair and pessimism, and back. As such, it forms the quantitative backbone for every chapter of this book. Appendix A provides detailed breakdowns of the startups that

* For a discussion of when “hybrid” methods (those that integrate qualitative and quantitative methods) are appropriate for domains in which our knowledge of a phenomenon is still developing, see Edmondson et al. (2007).

participated in the surveys as well as the survey questions posed to entrepreneurs.

The dataset and case studies both focus on the two most central industries for high-potential startups, technology and life sciences.* Together, these industries dominate every measure of young startup employment and funding. Of the initial public offerings (IPOs) during the decade (2000–2009), 48% came from those two industries, and no other industry accounted for more than 12%.³⁰ Furthermore, of the angel capital invested during the decade, 74% went to those two industries,³¹ as did 71% of venture capital.³² Many more low-tech “small businesses” (themselves the subject of a growing literature) start up each year than high-potential startups, but most of those small businesses lack employees and do not intend to grow or innovate.³³ This leaves high-potential startups as the core of the economic growth associated with entrepreneurship.

My focus on technology and life sciences startups in the United States allows us to examine the tensions between wealth and control, particularly potent in these startups because of their intense need for outside resources and because of the terms under which entrepreneurs typically acquire those resources. Including large numbers of both technology and life sciences startups enables us to compare the data and dynamics from those very different industries and assess which patterns are industry-specific.[†] Where we find patterns common to both industries, we can feel more confident that they generalize to startups outside these two industries. On the other hand, the degree to which the patterns described here apply outside the United States is an open question that deserves empirical attention. A lack of financing options in many other countries may preclude founders from considering some of the investor-related

* I will usually focus on the commonalities across these two industries, but at times I will also use the technology startups as a baseline against which to observe differences between them and life-sciences startups (e.g., in the preponderance of solo founders and in the amounts of capital they raise from investors).

[†] But even for patterns that are common to both information technology startups and life sciences startups, we cannot conclude that they are universal without further cross-industry analysis.

decisions described in Chapter 9, while a lack of experienced executives might preclude some of the hiring dilemmas described in Chapter 8. In other industries, such as those that are not capital-intensive or those that can attract customer revenues before they incur expenses (such as those in which subscription-based business models proliferate), founders may not have to consider outside financing options because they can fund their startups themselves. The applicability to those industries of the dilemmas described here is likewise an open question, one taken up in detail in Chapter 11.

INTRODUCTION TO THE PRINCIPAL CASE STUDIES

Of the more than three dozen case studies of founders of high-potential startups we'll examine, I chose to highlight seven across multiple chapters, both for the insights gained from the dilemmas faced by the founders and for the window these case studies collectively open on a wide range of circumstances, dilemmas, decisions, trade-offs, and outcomes. Figure 1.3 summarizes these seven startups in terms of their founders' backgrounds, their founding teams, and their hiring and investor decisions.* Let's briefly meet these six entrepreneurs (in addition to Evan Williams, whom we've already met) and introduce the dilemmas they faced in starting and running their businesses.

Pandora Radio's Tim Westergren is as unlikely a founder as you could imagine. He studied piano and political science at Stanford, then worked as a nanny, ran an admissions office at Stanford, and started a rock band, touring with it for nearly a decade before deciding to move on to freelance composing. During his composing years, Tim had the idea to create a music database (which he called the "music genome project") that categorized music based on a long list of attributes and that suggested to users new artists and songs that fit their tastes. In 1999, Tim met Jon Kraft, a Silicon Valley

* Full-length Harvard Business School case studies are available from HBS Publishing for each of the principal case studies below and for most of the other cases discussed in this book. Appendix B provides full citations for those cases.

<i>Startup (Core Founder)</i>	<i>First-Time Founder?</i>	<i>Solo Founder?</i>	<i>Prior Relationship with Cofounders</i>	<i>Hiring</i>	<i>Investors</i>
Pandora Radio (Tim Westergren)	Yes	No	Acquaintances	Friends	Friends
Masergy (Barry Nalls)	Yes	Yes	N/A	Young, replace as startup scales	Top partners from top VC firms
Smartix (Vivek Khuller)	Yes	No	Classmates (and one prior coworker)	Pre-hiring	Pre- funding
Sittercity (Genevieve Thiers)	Yes	Yes	“Couple- preneur”	Young, replace as startup scales	Angel investors
Ockham Technologies (Jim Triandiflou)	Yes	No	Prior coworkers	N/A	Deciding on angel vs. VC
Blogger/Odeo (Evan Williams)	Serial founder	No	Various	Various	Various
FeedBurner (Dick Costolo)	Serial founding team	No	Prior coworkers	Various	Various

Figure 1.3. Principal Case Studies

entrepreneur. The two decided to pursue Tim’s idea and formed Pandora (originally called Savage Beast), adding Will Glaser, a talented software engineer, as the third cofounder and CTO. The team split the equity equally, adopted a clear division of labor that matched their very different areas of expertise, and gave each founder autonomy to make hiring and business decisions within his own function. However, as the company burned through its dwindling cash and had to defer founder and employee salaries, these early decisions about roles and team structure heightened tensions within the team and exacerbated personal problems, leading Jon to leave and causing problems for the remaining founders.

Masergy's Barry Nalls also had an intriguing background. Some in the entrepreneurship world might call him a late bloomer—something he acknowledges but regrets. Barry joined GTE, a large telecommunications company, right out of school and over the next 25 years steadily climbed the ranks, gaining deep sales experience, profit-and-loss responsibility, and other executive skills. When GTE announced merger plans, he left to work for a couple of young companies. He finally took the leap himself and founded a telecom service provider called Masergy. A self-described “solo guy,” Barry decided to be the sole founder and CEO of Masergy and used a six-month severance from his last employer to fund his startup until finally raising millions of dollars from VCs. Although his startup benefitted from his wealth of prior work experience, it was only after taking the founder's leap that Barry learned key lessons about hiring a team for a fast-growing startup, managing a board of directors, and negotiating the tensions between sales and operations.

Vivek Khuller of Smartix, our next founder, struggled with the other side of the problem faced by Barry: Would a young MBA student be able to revolutionize an industry about which he knew next to nothing? While Vivek was working as a summer intern at an investment bank, he conceived the idea of using electronic-ticketing technology to allow sports and entertainment venues to issue and process their own tickets, thus eliminating intermediary ticketing agencies such as Ticketmaster. Vivek decided to advertise for co-founders within his MBA program, choosing two bright classmates with backgrounds similar to his own. Through his business school contacts, Vivek was able to pitch his idea to several high-profile venues, which were interested in partnering with Smartix, and to several top-tier VC firms, one of which issued a term sheet. However, his early founding decisions soon came back to haunt him.

For **Genevieve Thiers, founder of Sittercity**, the biggest dilemma was also highly personal: Her most important coworker was also her fiancé, Dan. What would happen to the business if she and Dan broke up? And what would happen to her relationship with Dan if their business relationship soured? The epiphany behind Sittercity had come to Genevieve as she was helping a pregnant woman post

fliers for a babysitter. Reaching back to her own experiences as a professional babysitter, Genevieve realized that a website allowing parents to quickly access babysitters could be a winning idea. After graduation, she worked as a technical writer at IBM and pursued her avocation as an opera singer, developing Sittercity in her spare time. When IBM shut down her division, Genevieve focused on Sittercity full-time. As the startup grew, she enlisted Dan as a technical advisor, and the two worked closely to build the business. Dan eventually became COO, but Genevieve was nervous about the arrangement. She needed to find creative and essential ways to erect “firewalls” to protect herself from the inherent dangers of her early choice of a coworker.

By contrast, **Jim Triandiflou of Ockham Technologies** experienced a dilemma that most entrepreneurs would envy: choosing from a number of interested investors. Jim suspected that the decision would deeply affect the company’s future and his own role in it. Should he choose the angel investor who came with few strings attached or the VC firms that expected more control but would provide needed resources? Jim was the son of schoolteachers; his father was risk-averse, having worked in the same classroom for 33 years, and Jim saw himself in the same mold. With a degree in marketing and an MBA, Jim had been working at a consulting firm and not even thinking of taking the plunge as an entrepreneur. But after talking to his colleague Ken about Ken’s idea for a sales-management software startup, Jim decided to give it a try. Jim and Ken recruited Mike, who had worked for Jim at the consulting firm, as the third cofounder of Ockham Technologies. The arrival of his first child convinced Ken not to quit his job to join Ockham after all, leaving Jim and Mike to proceed on their own. In short order, they landed IBM as a customer and used an outsourcing company to develop their software. As CEO, Jim was successful at pitching the concept to investors, but each investor’s offer would hold significant implications for Ockham’s growth and development.

The book’s final primary case study focuses on **Dick Costolo, founder of FeedBurner and three prior startups and, subsequently, CEO of Twitter**. After collaborating on several startups, Dick and

his “serial founding team” seemed to have developed a winning formula for low-tension, high-value cofounding. Before embarking on his business career, Dick had been a Chicago stand-up comedian. After a few years working as an engineer at Andersen Consulting, he became frustrated by Andersen’s lack of interest in pursuing Internet technologies and left with a colleague to start a website consulting company. In their early startups, the team ran into problems with poorly chosen hires, with investors, and with each other. But the founding team stuck together, in the process losing one cofounder while adding three others. In their fourth attempt, FeedBurner, they seemed to hit on all cylinders as they applied lessons from their prior startups. They were within striking distance of the Promised Land when they learned that even a smoothly functioning team can fall into disagreement as it nears the finish line. After solving those dilemmas, Dick went on to become part of one of the highest-profile founder-CEO succession events ever, taking the helm at Twitter.

These founders appear throughout the book. Other founders, such as a husband-and-wife team who founded a life sciences startup, play important roles in individual chapters. As a group, these founders are extremely varied, with very different personalities, styles, backgrounds, and abilities. Yet, as we’ll see, the dilemmas they face are surprisingly similar. All must decide when to make the leap into founderhood, whether and how to cofound with others, when and how to hire nonfounding employees, and whether to self-fund or raise outside capital. At each fork in the road, the wrong decision can send the startup over a cliff or bring about the founder’s replacement as leader of the expedition. Less dramatically, each outcome also heightens the startup’s chances of success or failure.

Founders embarking on their entrepreneurial journey have had no roadmap to follow, no way to anticipate the forks, potholes, and ditches they may encounter. By arming entrepreneurs with a founders’ roadmap, I want to point out common pitfalls, improve the stability and effectiveness of their teams, and help them reach their desired destinations. Our three dozen case studies will map the terrain, and our data on 10,000 founders will show us how

often each decision is made and with what implications. Founders who gain insights into their core motivations for embarking on this perilous startup journey should also gain understanding of the trade-offs they will have to make each step of the way and which choices will help them reach their destination.

The first fork in the road is the pre-founding decision about whether and when to embark on the journey. As I will argue, when three factors—career factors, market factors, and personal factors—are all favorable, the decision is easy. However, potential founders who encounter one or more unfavorable factors grapple with real dilemmas about when to found, potentially imperiling the startup, their family situations, or their ability to embark on an entrepreneurial journey in the first place. These three factors, and the ways in which they should affect the decision to found a company, are the focus of Chapter 2.