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“Follow your heart.” “Make your passion your business.” “Intuition should rule the day.” We are surrounded by messages that reinforce the impression that gut-driven entrepreneurial decisions will take us to glory, that we should build our startups on a foundation built on our natural inclinations.

Steve Jobs had a caution about this mode of entrepreneurial decision making: “Follow your heart, but check it with your head.” Before defaulting to the gut, make sure you’ve also engaged the brain. Make sure you’ve thought ahead to the potential consequences of your decision. If the head and heart agree, then terrific: You’re off and running. However, if they disagree, pull back on the reins before you default to what your gut is telling you, for it may be leading you into trouble rather than glory.

ONE FOUNDER’S EXHORTATION, 16,000 FOUNDERS’ EXPERIENCES

Jobs’ message flies in the face of what many entrepreneurs want to believe but has been reinforced time and time again by my research. I focus on the early decisions founders make about the people they involve in their startups and how they involve them. These people include themselves (as “core founders”), cofounders (the people who come onboard around the time of founding to help build the startup), hires (who fill holes in the founding team or help it deal with growth issues), investors (outside providers of capital), and members of the early board of directors. To study them, I draw upon my own entrepreneurial experiences, my firsthand observations of dozens of founders, and a dataset of 16,000 U.S. founders that I have collected since 2000.

The recurring theme of the research reinforces Jobs’ wisdom: Founders who default to their heart without checking with their head heighten the chances that their founding teams will splinter, that growth will be harmed, and that they will be replaced as leader of the startup. When it comes to making product and market decisions, it’s possible that following your heart will lead you to glory. However, when it comes to making people decisions, checking with your head is particularly important. Despite all of the attention paid to product development and market-related issues within startups,
among startups that fail, people problems are the leading cause by far, accounting for nearly two-thirds of the failures.³

**HEIGHTENED POTENTIAL, OR HEIGHTENED RISKS?**

Founders add new people with the hope that they and their resources will heighten the potential of the startup. However, those decisions also add risks to the startup, introduce new dilemmas, and could dramatically change the dynamics with the team and the startup.

For founders, the key is to understand ahead of time when they will be making a key people decision and how the options they face could heighten the potential while increasing the risks.

Likewise, for potential hires and investors, the key is to understand which prior founding decisions should be assessed before deciding whether to become involved in the startup. Have the founders built a solid foundation of forward-looking decisions that will heighten potential while reducing risks? If so, then you should be more willing to get involved in the startup. Have they made ill-considered decisions that heighten the risk of team fragmentation or stunted growth? If so, that should be a red flag making you twice about becoming involved.

In this chapter, I focus on the early decisions founders face about whom to involve in the founding team and how to involve them. We will briefly see that the patterns can be extended to early decisions about hires. The most central of those hires is the most important hire a founder might make: his or her successor as CEO, a key inflection point that will be covered in a later chapter but deserves attention here too.

**FOUNDING TEAM PITFALLS: THE 3RS**

When it comes to founding-team decisions, the most common decisions we make when we are following our heart tend to be the most fraught with peril. This is true of all three major areas of founding-team decisions, which we will call “the 3Rs”: the prior Relationships among the cofounders, how they allocate the Roles and decision making, and how they allocate the Rewards.⁴ For instance:

- **Relationships**: The most common prior relationships among cofounders are people who knew each other socially but not professionally—most centrally, friends and family. Yet, teams comprised of friends of family are the least stable in the long run.
- **Roles and decision making**: The most common titles taken by founders are C-level titles, and the most common approach to decision making is unanimity or consensus. However, over time, the title inflation comes back to haunt many startups, and the approach to decision making slows down the startup and increases tensions.
- **Rewards**: The most common approaches to splitting the most important reward, the equity ownership of the company, heighten the chances that the team will have disincentive to continue fully contributing to the startup and that it will not be able to deal effectively with a cofounder’s leaving the team.

Let’s delve into the most fateful early decisions, whether they tend to heighten potential or heighten challenges and whether there are ways we can reinforce the potential while reducing the challenges.⁵

**RELATIONSHIPS**

Where do cofounders find each other? In my dataset, more than half of the startups were cofounded by people who were prior friends or relatives—those who had a social connection bringing them together. This is understandable. It’s far easier to find and reach them and we already feel comfortable with them. As Steve Wozniak, Steve Jobs’ cofounder at Apple, said, “To be two best friends starting a company. Wow. I knew right then that I’d do it. How could I not?”⁶

Yet, after an initial honeymoon period of 6 to 12 months, these “social” founding teams are significantly less stable than founding teams comprised of prior coworkers. (There are also hybrid teams in which friends later cofounded
together, thus building a professional relationship on top of the social one, or in which coworkers became close socially.) Most striking to me when I saw the results of our analyses’ was that social founding teams were even less stable than teams comprised of prior strangers or acquaintances. What could be going on here?

As I homed in on the challenges faced by social teams, two major factors emerged.

First, despite their seeming closeness, those teams were less likely to discuss the elephants in the room—the conflict-ridden issues that tend to get bigger and worse if we avoid them. Our natural conflict avoidance leads us to push off discussing those issues, especially with those with whom we are socially close.

When we cofound with people we barely know, we enter with eyes wide open, assessing each other’s capabilities, watching for any disconnects in working style, and discussing goals and values to assess compatibility. We “date” before deciding whether to get “married.” However, when we are socially close with cofounders, we make the bold assumption that we already know each other (and thus will be compatible in the very different professional arena) and that we already trust each other. We neglect to consider that social trust—“he’ll have my back”—is very different from trusting professionally in the other person’s competence and ability to execute. We bypass the dating, making bold assumptions about our compatibility.

The second factor arises when the team almost inevitably hits a bump in the road. For instance, a founder isn’t scaling with the startup or the founders disagree about a key hire or change in strategy. As these tensions rise within the startup, they risk imperiling our cherished relationships outside the startup. Yet, we are much less likely to have protected those relationships, or, in the opposite direction, to protect the startup from blow-ups outside of it (e.g., when a couple who founded together get divorced).

When both of these factors are true—we avoid the difficult conversations and risk causing damage to our most-cherished relationships if things blow up—we are playing with fire. The more we play with fire, the greater the chance that we will get burned. As the Chinese proverb says, “If you mix family and business, you will lose both.”

Regarding the first factor, teams should proactively increase the chances that they will discuss the elephants in room, either by taking to heart the data about team stability and using it to motivate them to reduce their risks together or by tapping a trusted third party to facilitate those conversations. Regarding the second factor, teams should force themselves to list and then prioritize the pitfalls they might face as they grow and create disaster plans for how to deal with them if they occur. If a founder isn’t scaling, how should that be handled? If the two cofounders aren’t agreeing on strategic direction or are fighting at home, which one should exit from the startup? When playing with fire, such firewalls can help protect both the startup and the cherished relationships outside of it.

Teams that follow these prescriptions are much more likely to become the glorious team that Steve Wozniak dreamed about having with his best friend rather than a team that can cause the downfall of even the best idea. Hires and investors who assess whether the founding team has realized the challenges it faces and has found productive solutions to those challenges should be even more impressed with that team’s self-awareness and ability to deal with difficult issues.

ROLES AND DECISION MAKING

Founding teams typically start out with a “one for all, all for one” culture. They involve everyone in every major decision and seek consensus in the quest for solid decisions that incorporate disparate points of view. The founders find it motivating to be equals.

When it comes time to adopt titles within the startup, whether at the beginning or when they first have to present themselves to an outsider, the founders take senior titles. Often, they are all “Chief-something”: Chief Executive Officer, Chief
Technology Officer, Chief Operating Officer, Chief Financial Officer. (Maybe even Chief Yahoo, Chief Internet Evangelist, and other actual titles at prominent startups.) Layered on top of this title inflation is the fact that initially, when they haven’t yet raised any outside capital, all of the founders usually sit on the so-called board of directors.

The result is a reinforcing set of expectations about roles and decision making that can come back to haunt the team. With growth, the team usually realizes the need to adopt a clear hierarchy, to have decisions made by a subset of employees, and often that experienced hires might need to be brought in above the early members of the team. At that point, the deeply ingrained “equals” model is extremely hard to change as people feel left out of key decisions and even demoted.

The “easy” early model, which might have made perfect sense in the beginning, has now come back to constrain the team’s ability to change and to heighten tensions rather than reduce them. The heart fights against even the most rational head-driven change. Teams that understand this long-term evolution and set early expectations accordingly are much better at dealing with this transition.

REWARDS

Nearly three-quarters of founding teams in my dataset split the equity within a month of founding. Those teams are much more likely to split the equity equally and quickly, what I call “the quick handshake.” Are those common rewards decisions good ones?

Thomas Hellmann and I analyzed founding team equity splits to see whether the quick handshake was good for founders.8 Succumbing to a quick handshake, i.e., avoiding a difficult conversation about potentially differing contributions, levels of commitment, and incentives, is not a good decision. For instance, startups whose founders adopt a quick-handshake equity split suffer a significant valuation discount when they raise their first round of financing (if they raise at all).

It’s not simply that by avoiding a quick handshake you can avoid the valuation discount. Instead, there are inherent characteristics, such as conflict avoidance, immaturity, and weak negotiating skills, that may lead teams to adopt a quick handshake and might likewise harm their ability to raise capital. For instance, teams with fewer years of work experience are likelier to suffer the valuation discount.

I have also delved deeply into additional aspects of equity splits that have important implications for team stability. For example, the majority of teams don’t allow for any future adjustments to the founders’ equity stakes, instead adopting a static split that persists despite changes in roles, involvement, and other aspects of value creation. (After all, raising such an issue, in which you are voicing doubts about your cofounder’s potential commitment to the startup, can lead to a tension-filled conversation. There are clear parallels to our avoidance of the prenuptial conversations that we avoid having with our future spouses!) Given the ups and downs of startup life, the likelihood that something will change is high, yet the typical split does not adjust despite some fundamental changes internally.

Relatively simple structural solutions exist, such as time-based vesting. However, those are effective only insofar as the team is able to effectively discuss the issues that lead to their adoption.9 Once again, teams can benefit from having a trusted third party involved.

ECHOES IN HIRING DILEMMAS AND FOUNDER-CEO SUCCESSION

The 3Rs also apply to hiring dilemmas, when you’re deciding where to look for potential hires, what roles to fill, how to involve them in decision making, and how to reward them.

Some very pointed echoes come at the inflection point where the founder is considering making his or her most important hire and shift in roles: A successor who will replace the founder as CEO. The most gut-wrenching and startup-threatening successions occur involuntarily, when the board
or investors push the founder to step aside. In my dataset, 73% of the succession events were involuntary.

In those cases, the founder almost always resists being replaced as the parent of his baby. The heart overrules any messages from the head about why to buy in to the transition. Jack Dorsey, the early founder-CEO of Twitter, captured poignantly the visceral reaction that founders have to being replaced. Of being fired as CEO of Twitter, he said, “It was like being punched in the stomach.”

In fact, in a “paradox of entrepreneurial success,” the most successful founders—those who spark the fastest growth and who succeed at raising the most capital—are the ones who face a particularly heightened risk of being replaced involuntarily. In short, the fast growth outstrips their ability to learn about the evolving challenges their startup is facing, and raising outside capital shifts the power structure within the board away from the founders and toward outsiders. Add to that the fact that their very success makes successful founders the least receptive to the message that the board wants to change CEOs, and you’re heading toward a high-stakes inflection point in the life of the startup, both for the founder personally and for the company more broadly.

Quantitative analyses of the 6,130 startups in my dataset highlight how during the early years of the startup, founder control of the CEO position and the board can be a benefit to the startup but can quickly turn into a detriment to the company’s value as the company grows and evolves. At that point, founders usually have to face a significant tradeoff between remaining kings of their startups versus growing the most valuable kingdoms, a tradeoff that few founders are willing to acknowledge or prepared to think through. It is also a key tradeoff for investors and board members to understand and consider in making decisions about leadership, funding, and governance.

**EARLY SEEDS GROW INTO LATER PROBLEMS**

The seeds of trouble are planted early. Founding teams who architect a fragile 3Rs foundation often find ways to justify their decisions in the short run, only to find that they planted early seeds that have grown into later problems. At that point, it is often much harder to hit the Undo key on those decisions. Instead, founders should proactively learn about the forks in the road where they will be making key early decisions, and proactively reflect on their natural inclinations and how they might become sources of later fragility.

With a fuller roadmap and deeper knowledge of how their own weaknesses might need counterbalancing, their great ideas have a better shot at having deep, long-term impact on the world, to the point where their startups can become large public companies realizing the founders’ vision.

**REFERENCES**

1. These data come from the largest two industries in the U.S. for high-potential startups, high tech and life sciences. Those two industries receive by far the most venture capital and account for the most IPOs.

2. At the same time, the core thrust of the Lean Startup movement seems to question even this assertion, for its best practices are geared to checking the founder’s product intuition using A/B testing, data-driven hypothesis assessment, and quantitative metrics.


4. There is another very legitimate option for some types of founders in some types of startups that would help them avoid the challenges involved with the 3Rs: solo founding. However,
only 16 percent of the startups in my dataset were solo founded, making it very much the path less taken within American high-tech and life-sciences startups. For more details and data, please see Chapter 3 of The Founder’s Dilemmas.

5. For further details and data on each of the 3Rs, please see Chapter 4 (Relationship Dilemmas), Chapter 5 (Role and Decision Making Dilemmas), and Chapter 6 (Reward Dilemmas) of The Founder’s Dilemmas.

6. Wozniak, S. 2006. iWoz: Computer Geek to Cult Icon: How I Invented the Personal Computer, Co-Founded Apple, and Had Fun Doing It. W. W. Norton. Page 172. Later, the former best friends fought over many substantial issues (e.g., whether to shift Apple’s emphasis away from Wozniak’s Apple II computer and toward Jobs’ Lisa computer) and symbolic ones (e.g., who would get the lower employee number) before Wozniak left the company in 1984.

7. I collaborated on this analysis with Dr. Matt Marx of MIT Sloan.


9. Each of those solutions can also introduce their own challenges. For more on the issues introduced by time-based vesting or milestone-based vesting and which types of teams should adopt each type, please see Chapter 6 of The Founder’s Dilemmas.


12. For more on the best practices of managing this key inflection point, see Chapter 10 of The Founder’s Dilemmas.

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