

Exploratory Note 4

Founders' Dilemmas

INTRODUCTION

When to found? What kind of team? What type of financing? What can happen when goals and/or risk tolerances are not aligned across principals and agents? The entrepreneurial world is rife with conflict—and not just between competing firms; indeed, entrepreneurs frequently find themselves (fiercely) at odds with their business partners and/or investors due to a particularly potent mix of asymmetric information, misaligned interests, and perverse incentives. Oftentimes, entrepreneurs want one thing and their financial benefactors another. Understandably, the end result of such misalignment can be disastrous for one or more parties. A full understanding of the mindset of different partners (counterparties) and recognition of potential sources of conflict is critical for both entrepreneurs and capitalists. Tonight's discussion is focused on fleshing out these issues, identifying relevant theories, and considering their applications—beginning with founders' dilemmas.

FOUNDERS' DILEMMAS

At Harvard Business School, Noam Wasserman teaches *Founder's Dilemmas*, a course that has received considerable acclaim. The core focus is the different early-stage decisions which founding entrepreneurs have to make which are likely to have a serious and lasting impact on their respective enterprises—whether positive or negative. Many of these key decisions—about when to found, what kind of team to assemble, and what type of financing to obtain—are very closely tied to finance. Consider the questions below from the viewpoint of a founding entrepreneur.

When to Found?

When is the best time to found a business operation? Right out of college? After working somewhere else for a few years? After working somewhere else for the better part of a career? Be especially cognizant of financial issues when considering these questions.

Let's start with right out of school. What are the pros and cons?

How about after working somewhere else for a couple of years? What are the pros and cons?

How about are working somewhere else for the better part of a career? What are the pros and cons?

What Kind of Team?

What kind of team is needed for the operation? Should an entrepreneur find cofounders (partners)? How should roles be split up amongst the cofounders? How about equity stakes? Be especially cognizant of financial issues when considering these questions.

Let's start with what kind of team is needed. What factors do we need to consider?

How about the decision as to inviting cofounders (partners)? What is particularly important when it comes to this?

How about the splitting of roles? What is particularly important when it comes to this?

Finally, what about equity stakes? How should equity be split? When should equity be granted? Does everybody need to put up cash to earn shares?

What Type of Financing?

What options are available to entrepreneurs? Are they looking for financial backers to bring more to the table than just money? If so, what? What are the tradeoffs associated with outside money? What is the effect of outside money on decision-making? What is the effect of outside money on motivation?

Starting with the type of options available to entrepreneurs. What are some of the options? Consider both debt and equity sources.

Is more than money expected of the financiers? If so, how does this limit the field of prospects?

What are the tradeoffs associated with outside money? Consider both debt and equity.

What is the effect of outside money on decision-making? Consider both debt and equity.

What is the effect of outside money on motivation? Consider both debt and equity.

CONCLUSIONS

These founding questions are absolutely critical. Early mistakes on issues of this kind of magnitude are not irreversible; however, they frequently do a great deal of damage, waste a lot of time, and kill good ideas before they even have a chance to find their footing.