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"Lather, Rinse, Repeat": FeedBurner's Serial Founding Team

"Is this the right time or is it still too early?" Dick Costolo wondered as he reflected on the latest acquisition offer. He had been building FeedBurner with his three co-founders for almost four years and was staring at the details of an acquisition offer from Google. He and his co-founders had founded three prior ventures together (see **Exhibit 1**), each of which had had increasingly attractive outcomes, but none of which had reached their full potential.

The number on the table from Google was a big one. If the deal were completed, it would be the biggest win the founding team had ever had. However, was this the right time to exit? If Costolo didn't think so, how would he be able to convince his co-founders, two of whom wanted to exit? This was going to be the biggest decision in the life of FeedBurner and its co-founders.

The Improv Comedian

Dick Costolo began his stint at the University of Michigan as a computer science major, but also developed an interest in theater and improvisational comedy. As his senior year came to a close in 1985, the allure of "improv" was quite strong. "I got so interested in the theater and comedy that even though I had job offers from several big computer companies in New York and Detroit, I turned them down to go to Chicago to do improv, to try to join Second City. " Costolo joined Chicago's Annoyance Theater, and learned a lot, including some lessons about team composition:

> My biggest team lesson was that you can't build a team from parts that "look like" they'll make a good team. We had a show with three people, all of them all-stars. Individually, they were hilarious, and some have gone on to greatness. We expected the show to be great. But everyone could see they weren't working well together on stage. I saw that you can't say, "On paper, this person is really funny, this one is really funny, and this one is really funny. We'll put them together in a show and it'll be really funny." It just doesn't work that way.

To enable him to continue doing improv part-time at the Annoyance, Costolo took a job at Andersen Consulting in Chicago, where he began working on systems integration, consulting, and development projects. He also worked in one of Andersen's technology centers, building the foundations of systems that the systems-integration consultants eventually took to market. At one point, Costolo managed a diverse team of 30–40 people, and got a lot of experience working with clients. He observed that "small project teams were usually more successful than big mega-projects."

Professor Noam Wasserman and independent researcher Eric Olson prepared this case. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

Costolo met his future co-founders while on his last project at Andersen. Marc Rettig and Matt Shobe were user-interface designers. Eric Lunt, a recent college graduate, was a software programmer on the architecture team, as was Steve Olechowski. In contrast to some other Andersen co-workers, Costolo perceived that these four teammates were more willing to take entrepreneurial risks. He also noticed that "we had very complementary competencies. For example, Eric was a solid architect, but didn't like to do user-interface work, and Matt is one of foremost user-interface people around but doesn't do back-end systems work or the business stuff that I do." The Web was just starting to take off and Costolo wanted to focus on Web projects, but upper management at Andersen considered the Web a fad, or not particularly useful for business. Frustrated, Costolo decided to leave Andersen. After a post-Andersen fling creating a British TV show called "Modern Problems in Science," Costolo decided to try starting his own technology company to do Web projects. In the meantime, Shobe left Andersen to return to graduate school to study human factors, and Olechowski left to join another company.

Burning Door and Digital Knowledge Assets

In late 1993, Costolo started Burning Door Networked Media to do Website consulting with his Andersen teammate Marc Rettig. Costolo recalled, "Marc was the most entrepreneurial and risk-seeking of all of us, was an early user of the Internet and knew it would be big, and had the most complementary skills to mine." Costolo had programming and computer science skills and Rettig was a top-notch designer. The complementary skill set began to pay dividends as the team sold project after project. However, Costolo began to realize that if he and Rettig were going to grow Burning Door, he was going to have to focus on selling and then find someone else to run the programming end. While at Andersen, Costolo had been impressed with Eric Lunt's skills as a software architect: "I could build a one-story house with a kit; Eric could design and build a high-rise." He reached out to Lunt, and convinced him to join Burning Door in the summer of 1994.

Over time, though, Costolo realized that he didn't enjoy being in a small consulting firm. He explained: "You're always having to sell the next thing, chasing project after project. We didn't have ways to get more leverage besides hiring people, and we'd have to fire them when times got lean. It's stressful and no fun." At this point, Burning Door was approached by two business guys they didn't know who were starting a Web company to build online communities. "We had a sense that they knew what they were doing on the business front but needed technology and architecture skills to support it." At first, the two business guys wanted to contract with Burning Door to build what would later become known as "blogging" tools. The CEO of the new company then brought up the idea of buying Burning Door. The Burning Door people would receive cash and a minority stake in the new company, would be co-VPs of Technology, and would drive the technology decisions; the others would own the vast majority of the equity, would be CEO and COO, and would drive the business decisions. The team would make decisions by "consensus." Welcoming the shift away from consulting, the Burning Door team agreed, and the five formed Digital Knowledge Assets (DKA).

After a year, because of developments in his personal life and a desire to start something new that he could run, Rettig decided to leave to start another firm, leaving the other four to build DKA.

Costolo and Lunt came into Digital Knowledge Assets feeling like equal founders, but they soon found out that they were not on equal footing with their new partners. Costolo recalled: "We came up with a cool element of the community-publishing platform: a 'Tour.' One of the early decisions the group faced was whether to flesh out Tours as its own product. The business guys argued that there's so much richness there that it would be compelling on its own. As the tech experts, Eric and I argued that we should stick to our original plan, keeping Tours simple, and being able to focus our efforts on the big-picture community program." However, two members of the management team were very vocal and eventually prevailed, so the team ended up doing Tours as a stand-alone product. The product ended up taking 8–10 months longer than expected, was a major distraction, and caused DKA to burn through half of its capital before they could get back to the "real" product. Costolo observed: "The leading cause of failure in a start-up is running out of money, and this brought us close to that point! The only time we got 'consensus' was when we did what those two most vocal and opinionated people wanted to do. Everyone else thought they were deferring to the experts, but having the strongest opinion doesn't make you an expert."

Once the team had their core product under development, they began to think about sales. They promptly hired a VP of Sales, a stellar salesperson with a fantastic Rolodex. The new VP of Sales immediately had potential customers interested in the product and came back to the team asking for a demonstration version he could show these potential customers. Costolo remembered, "He'd come back and tell us, 'We have to get something in front of them while we have them on the line.'"

> The user-interface people got excited and said, "we'll do cool things with it," but they put stuff in the demo that we couldn't implement later. So the customers saw things we could only do in a demo environment, and it led to inevitable customer disappointment when they didn't get it in the product itself. It was a double negative: it also distracted our software people from getting actual product done for us to sell. It was a major time sink and opportunity cost.

With the delay in completing the product, the team decided to slow the sales efforts and instead focus on completing a solid first version of the product. This gave the VP-Sales less to do, because "We had hired a guy who was specifically a VP-Sales and couldn't be anything else." DKA didn't want to fire him and then have to rehire him six months later, so they simply had to eat the expense and keep the VP-Sales interested while they got their product in order. After this incident, Costolo began to place a higher priority on hiring flexible people who could play multiple roles within the venture. "We might be hiring for a specific role, but we should look for someone who could go and do other things if the company heads in another direction in the next 5–6 months."

As the product evolved, the team needed expertise in user interfaces and software architecture. To fill those two holes, Costolo hired his old Andersen teammate Matt Shobe, who had finished graduate school, and Lunt brought in Andersen alum Steve Olechowski for the architecture team.

For its initial funding, DKA took $2 million from a large company where DKA's CEO had worked. Taking money from that "strategic investor" worked well for a while. For one thing, said Costolo, "We didn't have many board meetings because the people at the parent company were extremely comfortable with our CEO and were hands off, saying, 'Keep going, sounds great' to everything. I thought that having a board would be a distraction or just create busy work." Also, taking money from the strategic investor minimized the dilution of the founders' stakes. Over time, though, issues emerged. One was that the founders who owned the majority of the equity were so intent on avoiding dilution that they were focused on raising money only from the strategic investor. Costolo explained:

> When we wanted to change strategies to pursue a bigger opportunity, we needed more money to grow. However, our strategic investor's own strategy was changing and they no longer wanted to fund us. Because that investor was not a VC, they were not well suited to helping us pitch the deal, to get it out in front of real VCs. They also couldn't create a market for us by being ready to back up the truck with more money. The VCs we were pitching to were looking at it and worrying about having an A-round lead investor they weren't used to.

After six months of trying, the team realized that it wouldn't be able to raise its new round. Just then, DKA's CEO found a potential acquirer and quickly negotiated a sale: "Our CEO pulled a rabbit out of his hat. Selling became our only avenue because of how we had financed the company before. But it was not a homerun so there was a lot of grumbling," Costolo said. Another problem was the very unequal amounts of equity held by the founders: "Because we had differing amounts of equity, we had differing levels of desire to exit, and that caused a real divergence within the team."

Spyonit

One of the two "business guys" from DKA stayed with DKA post-acquisition, and the other left to pursue another opportunity. Three of DKA's Andersen alums quickly decided to co-found a new venture, although they weren't sure about its focus. Costolo recalled, "Eric and I definitely had the lather-rinse-repeat mindset—get the band back together and start another product company. Steve had not been in Burning Door from day one, and he was excited to have the chance to be in on the ground floor now." Giving in to arguments that "you should be in on the ground floor of our next thing," Matt Shobe decided to join the team instead of accepting an offer from Microsoft. While the team tried to figure out their next move, the four again decided to do consulting and made money doing projects for DKA's acquirer and some other companies.

Finding the next idea didn't take long. The four founders revisited an idea of Lunt's from DKA:

> At DKA, Marc Rettig had come up with an idea to develop an alert mechanism that when a community-server post you're interested in changes, you get an alert. For instance, "Someone commented on your comment." We had built alerts into the DKA product, and then Eric Lunt had outlined an idea to expand alerts to the entire Internet. Instead of just watching community-server pages, we could watch any Web page and alert you about changes. We had talked about it a little at DKA but didn't pursue the idea. We had called these alerts "spies."
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> Now, all four of us bounced around the idea again. Another company, NetMind, was doing something very similar. It became pretty popular and raised venture capital, but all NetMind did was tell you when a page changed. We decided that our spies should be able to do more abstract and intelligent things—we'd architect it so people could say things like, "Let me know when this eBay auction goes over $36 or has more than six bidders."

Two of the founders began to shift away from consulting assignments to focus on the new business. Lunt shifted first in order to work on the underlying architecture, and when the architecture was ready to go, Costolo joined him full-time. Olechowski and Shobe continued working on a consulting project that was bringing in the revenues needed to bootstrap the venture.

Splitting Equity and Roles

They decided to name the business "Spyonit." The next decisions were about equity and roles. Costolo remembered:

> Eric, Steve and I became equal partners, but Matt was newer and hadn't been around long enough to warrant equal equity. We ended up at 25-25-25-15, with 10 left for options for employees. We felt that having the three of us be equal equity partners would result in the most aligned interests, the best decisions, and the least long-term acrimony—we wouldn't have someone say, "We sold for $X but should have waited for more because now he's rich but I'm not." We didn't value the idea over the execution or vice versa, just like we didn't value business development over engineering or back-end engineering over front-end engineering, or design over product. Giving the idea guy more equity is silly. Ideas are a dime a dozen.

> During the proto-stages, some of our roles just fell into a natural form: Eric was the lead software architect and de facto CTO, and I played the role of fundraising and running the company. But Steve wanted to have a more senior role, so Steve and I began sharing some of my tasks, and we had to figure out who was doing what.

In contrast to the "consensus" decision-making approach at DKA, the Spyonit team adopted an "expertise" approach. When an architecture issue arose, the rest of the team would voice their opinions, but the final decision was up to Lunt, the team's architecture expert, and likewise for other issues in another founder's area of expertise.

As Costolo headed out to raise money, he began making Olechowski the lead on the venture's legal work, given Olechowski's interest in that area. However, as Olechowski began to take on more business-related responsibilities, tensions grew. Costolo recalled:

> It was contentious at times. I would think I should be doing something, and he thought he should. So I just said, "Any product work related to a partner, you take it, Steve." It was very organic, a result of contentious discussions rather than our consciously mapping out territory. There are lots of things you have to learn about each other. You can't anticipate how the executive team should split things up, or what roles you should each play.

An outside event helped accelerate the definition of Olechowski's role. In his programming role, Olechowski had integrated Spyonit's spies into AOL's Instant Messaging client, which led to his having discussions with AOL about business development and M&A (merger and acquisition) possibilities. In the process, Olechowski began taking a very active role in business development. Costolo said, "Until AOL approached us, we didn't know we'd need anyone doing business development." Costolo also began to see how Olechowski's cautious style complemented his own, more open, style when it came to deal-making, which helped further refine their responsibilities. Costolo observed: "I saw that Steve was a natural at it and was the best suited to have business-development conversations. He had a good common-sense business approach, very unemotional. Steve ran the whole process with AOL, and business development became his specialty. He took on that role along with programming." The AOL opportunity eventually disappeared, but the effect on the team was much longer lasting: "His role took two years to evolve, but it gave Steve a significant piece of the company to run, and it allowed me to focus on product and operations."

Hiring Follies

It didn't take long for the team to find a function that none of the founders wanted to touch:

> None of us wanted to run hiring, so we brought in a person to run HR when we were only six people. A year later, we're looking at the code, asking why a certain component has so many bugs, and only then did we realize that we had hired several people who weren't cutting it! Our biggest mistake was hiring people too quickly rather than waiting until we found the right person. We hired people when we had an urgent need for a role, even if the person was not an A+ player. The HR guy was telling us, "This is a good person." We'd say, "He's not an A+ but he's the best of the five people we've interviewed and we have a desperate need." A year in, we realized we should not have hired the guy. You have to set an absolute bar; relative discussions are bad. There were three of those people, of the 12 we hired.
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> The worst problem with a bad hire is that they get into the organization, they become friends with people, and then it's, "Why are you firing my friend??"

> For other hires, when the going got tough, they began complaining. They didn't know what they were getting themselves into. The guy running HR would shrug and say, "I wanted to convince people to come here, sell them on Spyonit." You need a combination of that, plus warning that "it's not going to be easy, you might not last here, the work and hours are hard."
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> Hiring decisions became the HR guy's decisions, not the team's. But you need to find people who are a good cultural fit with the founding team, not just a fit with the HR person.
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> When we really needed to make a hire, we went all-out and put together a compensation package that was high both in salary and in equity. Down the road, that caused problems as others found out, and as we got closer to an exit.

The team's prior lesson about the need to hire flexible employees—"jacks of all trades"—was also tested by its Spyonit experiences. Costolo recounted:

> Turned out that our "jacks of all trades" had done a lot of things, but were not great in any of them. A jack of all trades is not someone you're confident moving to a new place. They were not the queen on the chess board, but a pawn—they had to go one step forward at a time rather than being able to go all the way across the board. As we needed to shift resources, we didn't have the right pieces to move around. We had to go and find someone else to fill that hole, and then we were stuck with the other people, who were still there with nothing to do. So hiring a jack of all trades actually made us *less* flexible. It really slowed us down. Afterwards, we would say to each other, "Boy if we only hadn't done that, we could have been a billion-dollar company." It slowed us down and limited our options. It gets harder and harder to turn the ship as the company develops, so the longer you can go with a highly flexible, nimble organization, you have a much bigger advantage.

Angels and Acquisitions

For funding, the team decided to raise an angel round, and attracted $850,000. Costolo remarked:

> We didn't know any VCs but we knew people who had sold companies and were interested in investing. We got a dozen accredited investors who took all common stock, no preferred stock at all. So far, so good. However, there were a few investors in the syndicate we didn't know well and they became problematic. They were making high-risk investments in a new company, but didn't feel like they could afford to lose their entire investment. It was a recipe for disaster. I had 13 people who, now that they had $20K invested, wanted to call me and ask about an article in the *Wall Street Journal*, taking 45 minutes of the CEO's time when he should be running the business!
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> We didn't form a board because it was an angel round. We did things randomly for six months, paying ourselves randomly. We ended up having to go back and put our books in order when we did a deal later, and it was a painful process. A board would have forced us to do things right and would have pointed out that the way we were hiring people could have used more rigor. We never formed a board, but if we had, we could have done much better.

At the end of 1999, Spyonit's competitor NetMind was bought for $360 million in cash, and the acquisition market began to heat up. Spyonit was contacted by 724 Solutions, an e-commerce software services company, just as Spyonit was starting to talk to VCs about a new round of funding. Costolo noted:

> A strategic investment would tie us to 724. They'd either have to end up buying us or we'd end up trying to buy them out of their investment. If they take a board seat, they would be asking at board meetings, "Why are you working with a competitor of ours?" It would force our hand and shut down opportunities. So Steve and I discussed it and told 724, "We're already talking to VCs about an investment. The only strategic investment we'll consider is a purchase of 100% of the common stock"—i.e., they have to buy the company.
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> While that was going on, I pitched several second-tier VCs we met through introductions. They had ridiculous questions about the business that a first-tier investor wouldn't ask. "Are you using an Oracle database? Why not Oracle?" Questions that were irrelevant to how successful a business you're going to build. A top VC like John Doerr at Kleiner Perkins wouldn't ask something that irrelevant. If you do your first few meetings with second-tier VCs, you might get discouraged, but you can't assume their questions and feedback are the same ones you'd get from top VCs.
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> I also learned that if you meet with venture-capital investors three times and they're still not "there," that's a no, but they don't want to say it because they want to participate later if things pan out. They all have their Monday partner meetings; if you're not invited to come pitch at one, stop talking with them or you'll get bogged down having meeting after meeting.

After pitching VCs for four months, the team was close to getting a term sheet from two of the top Chicago firms, ARCH and Portage Ventures. Their talks continued with 724 Solutions. Costolo:

> 724 told us, "You guys are going to run this, and we want to keep you in Chicago; you'll be working for the CEO of 724." Once we started talking with 724 about price, we realized we were getting a better price from them than from the VCs. 724 opened with, "Here's what we're thinking about: $20 million in stock, term of three years, with 1/3 upfront, 1/3 after two years, 1/3 after three years if you're an employee on that date." We wanted to front-load more, but they had done 2–3 other M&A deals and told us, "We used that structure for all of our deals."
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> We decided to negotiate the total value, and ended up at $53 million total. Very far down the path, though, we realized, "Why did we take their initial structure at face value, instead of saying, 'We don't like that structure'?" But when we brought it up, they said, "If you reopen that, we're going to reopen the price issue." It's another big reason to use VCs: experienced VCs have done 20 of these M&A deals, you're doing your first, and the VCs will have seen the problems that don't arise until a year after the deal is done.
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> Unfortunately, we did the deal in September 2000, and right after that the stock deteriorated. Also, after the sale, we weren't in control of our company any more. We were no longer responsible only to ourselves—there was now a big company in Canada that we had to report to. They had very different priorities. It was a drastic change.

Six months after the acquisition closed, 724 merged with another large company. 724's CEO became the chairman, and the other company's CEO became CEO of the combined company. The new CEO shifted the company's strategy to focus on mobile operators and reassigned Spyonit's team to the mobile effort, which meant they would have to move out of Chicago. However, as part of the acquisition terms, Olechowski had negotiated full acceleration on their earn-outs if they were moved out of Chicago, which now prevented 724 from moving the team. Costolo explained:

> The table you're playing at can look completely different in three months. You really do have to get everything in writing, even when—or especially when—they say, "Don't worry about that—our CEO loves you, we won't move you," or, "We're not going to fire you guys,

> you know the business better than everyone." I would have taken their lines, but Steve didn't take anything for granted. He was much more cynical. He'd say, "Maybe he's lying. If he won't move us, he should be willing to put it in writing."
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> We learned that selling the company doesn't de-risk all of the execution risk. If you think, "I'm going to sell because the money's good and they have all these resources and I'll make my baby into this beautiful thing," sometimes it actually increases risk because of the parent company's competing interests.
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> I learned that being locked up for three years is too long. Two years are plenty to integrate the company: you integrate in a year, then have one year to make sure it's working out. After that, I'm not running things anymore, so keeping me around is not helping either of us.

From Spyonit, the founders learned a lot about themselves and their team members. Costolo said:

> Steve and I can hop around a lot and do a lot of different things well—what you might call "best athletes." Steve and I could switch roles—he could run product management and I could run business development—and we'd be just as good. Eric and Matt are a different story. Eric is a software architect through and through; he couldn't manage a project any more than he could build a spaceship and fly to the moon. He has no interest in dealing with people and managing them. Matt is a user-interface designer, period.
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> Mapping out our roles early would certainly have helped. Having all four of us founders be best-athletes would also have been great. There were times when we needed Eric to manage a project for four months, but he had no interest or desire to do it, so it didn't happen. At the same time, we wouldn't have been able to develop the extensible architecture without Eric, and our user interface would have been worse without Matt. Steve and I would not have been able develop an architecture anywhere as flexible as Eric's.

FeedBurner

After leaving 724, Costolo "got the band back together" to discuss their next venture. He recalled:

> This time, we didn't need to discuss roles or equity. We knew that Eric would work on the architecture design and that I would go out and raise money. We knew that Steve would be doing much less on architecture and programming; now it was a given that he'd be the business-operations guy, dealing with legal, accounting, operations. Matt is and always will be the user-interface guy.
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> With the equity, we felt that we'd all been together for a significant amount of time, that Matt had gone through Spyonit and 724 with us. We decided that now we should all be on equal footing, with 25% each. My wife said, "You're splitting the equity equally and you're CEO??" When you're 19 and you're dating a 15 year old, it's shocking to your high school class. That was Matt at Spyonit. But when you're 40 and dating a 36 year old, it's in range. We felt that everyone's pretty equal now. We also knew now that Matt could contribute like the rest of us. Matt would be the critical "voice of the user" for us.

Once again, the team did consulting projects to pay the bills. Costolo remembered: "Then, one day at lunch, Eric had the idea that there would be a role for an intermediary who could help publishers aggregate all of their metrics and help them monetize their feeds and get distribution. We thought it would be a really big idea, and we knew we wanted to do something bigger in this next venture."

Shobe came up with the name "FeedBurner," and it was immediately adopted by the team. Costolo explained: "People like verbs in the name. It is easy to get people to talk about using the service if a verb is in the name. When we started seeing people referring to 'burn your feed,' we knew we had them."

Lunt immediately began prototyping the architecture, and Costolo headed out to pitch VCs in November of 2003. However, finding funding wasn't easy. Costolo recounted:

> I pitched a lot of venture guys out West in Silicon Valley. The guys in the Valley weren't "getting" the RSS phenomenon, weren't seeing why this would be important. So I started talking to one of the VCs we met at Spyonit, Portage Ventures in Chicago. We wouldn't have gotten a term sheet if not for our past success. Even Portage had doubts about RSS stuff, but they said, "These guys have done it before a couple of times, they're getting the band back together again—let's make sure we can be part of it." This time, we did not obsess about valuation and dilution. We negotiated all the points, not just valuation: Dividend, participation, liquidation preferences, size of options pool, everything. We waited until we were completely comfortable with the final documents.
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> After our randomness at Spyonit, I had decided that I would form a board when I raised any outside money. Most successful serial entrepreneurs raise institutional money quickly and form a board quickly. It's a great way to keep yourself in check, to be able to bounce ideas off people instead of going down blind alleys. It forces you to get your finances organized immediately, rather than after doing things randomly. So board makeup was a key focus.

The board would have three seats: one for the VC and two for founders. However, instead of agreeing that the non-VC seats would be filled by "one founder and one CEO who happens to be a founder," Costolo pushed for them to be "two founder seats." In contrast to past ventures, where the team had trouble figuring out which other founder should be on the board, it was clear that Olechowski should sit on the board with Costolo. This structure worked well. "There were three advantages: We already knew the investor really well, they were local so we'd get their attention when we needed it, and we knew the other partners in the VC firm so when it would come time to do the next round, it would go smoothly."

This time, the team decided to wait to begin hiring until after it had raised an A-round. Of its first four hires, two were on the business side and two on the technology side. Costolo remembered:

> We asked, "What part of G&A do we want to offload first?" and this time we decided to offload finance instead of HR. People asked me, "Why are you bringing in a VP of Finance so soon?" We wanted to do all the interviewing ourselves this time, and it made it easier to have someone take responsibility for the finance stuff. We also brought in a publisher-acquisition person to work with Steve and two more engineers. With these two business types and two engineers—"2+2"—we stayed balanced across those areas. If we had found 3+1 we would have taken it, but we wouldn't have hired four business people and no engineers.
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> We wanted people who could be "stem cells": generalists who could grow into "specialized organs" when we'd need them to. We decided, "Let's make sure we have people who can do more than one thing," so we would have the option to move them if needed. When we were 20 people or smaller, our org chart was very fluid. We could go to anyone in the group and say, "You're doing marketing for the next year." Our CFO had been a CEO and an operator, our head of publisher acquisition had done sales before, Steve had done coding and biz-dev.

> When we got to eight people, we did say, "Eric's not going to spend any more time on business meetings, he's full-time on technology." At that point, we'd shift resources within groups, within the technology side and within the business side, but not really across them.
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> Our first CFO always wanted to have org charts for the board because they add structure to the board deck, but I was perfectly happy month-to-month moving people around when we didn't find people we wanted to hire. In the end, five of our original 20 moved into radically different positions at some point. So most didn't move around.

New Hiring Challenges

The entrance of new employees highlighted new challenges. The founders were so familiar with each other that they often made important decisions with little more than brief, cryptic conversations that were hard for others to follow. The team began to realize that their hires would need more structure: "We brought in a person on the West Coast to run partnerships when Steve and I were both spending time on partners, and this person ended up having some issues with, 'Who am I reporting to, you or Steve? I'm getting different answers from each.' As we start to grow, we can't have a loose oligarchy; we need people to be in charge of different things." The hiring and compensation approaches also changed. Costolo continued:

> In the past, we had hired people who looked great on paper—the guy who had all the right credentials, great grades, knew all the programming languages. But during an interview, I often got the feeling, "Not really one of us." At Spyonit, we would have hired him anyway, but seeing the problems it caused reminded me of the problems I had seen with the team of "improv" all-stars, where the fit between personalities was so much more important than just finding people who had great "test scores."
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> Each hire would be either an equity-heavy hire with below-market salary, or salary-heavy with below-market equity. When we would make people offers, I would ask, "Do you want us to favor salary *or* equity?" For the ones who favored salary, I told them, "Well, no complaints when it comes time to sell the company and your colleagues are going through the roof and you mortgaged your future for more salary." Sales guys are particularly interested in salary over equity. A good sales guy wants to know, how much can I make this year on my W-2?
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> With engineers, our hiring rule now was "no false positives"—they had to be a perfect hire. They're writing code, and you'll get bad code for 8–10 months because it takes that long to find that it's bad code, and then the next people have to clean it all up.
>
> You can't do that with salespeople, though. They move around very quickly; if we'd apply a "no false positives" hiring rule to salespeople, they would have taken another job by the time we decided to make an offer. Also, you're not able to judge them just by meeting them, because all salespeople are great at making good impressions, even if you do several interviews. Just get them in and see how well they sell. Make the compensation package based on how much more they'll make if they meet or beat quota, and I as CEO have to be comfortable with their making four times as much as me, but with their having a low base and huge upside. A salesperson will leave if he's not doing a good job and therefore not getting paid what he wants. If he doesn't work out, it solves itself quickly. It's "hire fast, fire fast."
>
> You want some people to be aligned with you on the equity side, but not everyone has to be totally aligned; in fact, you only need a few people to be. You really want your key business-development guys to be in same boat as you, thinking about, "If we do this, will there be a lot more upside?" But you don't need the people in engineering or operations, or the finance

> person. You want your founders and your senior executives, but everyone else can choose their own weapon of salary versus equity.
>
> When you hire engineers here in Chicago, they're more interested in salary than options. In Silicon Valley, the discussions are, "Can you give me more options if I take less salary?" Here, we always had the opposite discussion with engineers. If everyone chooses salary, I'd advise them against it, but I'm fine with that. You adjust your burn rate upwards, but there's a lot more equity still in the bank than you thought there would be. You thought you had N% of the company, but everyone took salary, so you actually own N times 1.2!

B-rounds and Business Models

In early 2005, after much work on the product, it was time to put together another round of funding. Costolo recalled, "We were burning $100K/month and had six months left. I said to the team, 'We're not going to wait until March–April when we have only $300K. If we take it down to the wire, the VC will sit on it for a few weeks until they know we don't have money, have to sign their term sheet, and have to take their terms.'" Soon after, FeedBurner was approached by Google and Yahoo!, each wanting to discuss acquiring the venture. Costolo told the VCs, "We're having discussions about acquisition that will be wrapped up soon. We'll either do financing with you or take one of those acquisition offers." He noted: "Having the potential acquirers involved changed the dynamic with potential investors. It kept acquirers from wasting our time with stupid offers and prevented a lot of back and forth with the VCs on harsh terms."

At this point, FeedBurner had 11 people working for it. In addition to finally putting together the company's first org chart, FeedBurner's CFO suggested they re-examine their stock-options plan. Until now, Costolo had negotiated each new employee's terms separately. For instance, the most in-demand hires had negotiated for themselves full acceleration on change in control, while others got none or partial acceleration. Costolo said, "Our CFO had been a VC and pointed out that we needed to get this cleaned up so all new hires would be in the same boat. The worst thing you can have is when you sell, if things aren't consistent, you have employees looking around and saying, 'That guy wants to now be fired because of his acceleration,' and everyone's interests aren't aligned." In addition, with FeedBurner's plans to start hiring a lot more people, the potential new VCs were asking about the options plan. In the end, the team decided that all future employees would have consistent partial acceleration: 25% on change in control, another 25% on any termination after a change in control. Future equity grants would be consistent in both number and function.

In the end, FeedBurner couldn't agree on a price with either of the potential acquirers, so they decided, "This is a bigger opportunity, we understand the execution risk, and there's a lot more value for us to build." Costolo recounted, "This time we took the VC financing instead of taking the M&A offer. Our 724 experiences forced us to realize that once you do the deal, you've exited. We had regrets because at Spyonit we could have kept going to grow it much bigger."

With the closing of the round in March 2005, the board grew to five people: two founders, two VCs, and an independent director who would be nominated by Costolo. Costolo proposed that they add Matt Blumberg, founder-CEO of ReturnPath, an email-services venture.

> As it turns out, I love having another CEO on the board. As founder-CEO, you're alone at the center of an hourglass-shaped reporting structure in which all the employees report up to you, and then you report up to all the investors/shareholders. Now, Matt's the only person involved in the company who knows exactly what I'm dealing with, is my peer, and generally feels the same way I do about the next steps in the life of the company.

Regarding the company's monetization strategy, the founders had initially planned to leverage an existing ad network, like Google's or Yahoo!'s. Costolo was very disappointed in the results: "We had horrible click-through rates (CTRs) from using their networks. A good CTR is .2% to .4% and we were getting .02%, an order of magnitude lower than what it should be." He explained:

> Going back to my improv days, another classic lesson for me was, "Don't ask lots of questions, just make initiation and put a stake in the ground." Questions drag a scene down. You don't start off asking, "Are you my mom?" but instead say, "Hello, son, clean up your room." In the early days of a business, instead of asking lots of questions about market size and sales strategy, put a stake in ground and then react from there. Don't do six-month or one-year product road maps, do three months or shorter, and then move from there.
>
> Eric's architecture was flexible enough for us to try a bunch of things to test our hypotheses about the CTRs. E.g., "Let's try putting an ad in only the first post," and you see that the CTRs still stink. "Let's try a different vertical." Nothing worked. But because we could turn it around so quickly, it wouldn't take us two months to do another test, it would be each week. From that, we realized that with Google and Yahoo! searches, contextual ads work because people find something related to what they're searching for. In feeds, though, no one is searching; they are reading because they subscribe to a person. They are choosing the writer, not the topic, so click-through rates aren't close to what they should be.

The founders decided to build their own "brand advertising" ad network and ad-sales team, a huge change to FeedBurner's strategy. Because brand advertising is targeted using overall reader demographics, it would be a better fit with FeedBurner's feed ads. Although none of the venture's employees had any experience with such ads, Costolo believed that Brent, a "stem cell" employee who was focused on recruiting publishers, might be able to become the head of ad sales.

> He had never sold ads in his life, but he was the most knowledgeable about ads. He had been the CEO of a dot-com, knew online media networks, knew a lot of the key figures. He was the one who could go out to customers and not sound like an idiot. I told him, "Now you're in charge of ad sales. We're going to build out our own ad network. Sell ads for us." He said, "Whatever you need me to do," and became our head of ad sales (see **Exhibit 2**).

However, the usefulness of such "stem cells" began to change as the venture grew past 20 people. (See **Exhibit 3** for the growth in employees.) Costolo observed:

> The business needs more of an emphasis on specialists now. In engineering, we need great Java architects who can jump into someone else's code and understand it, and who specialize in writing great Java code. We've started to say, "We need people who eat, drink, and sleep Java code." I don't care any more if they can do C++ code or if they can manage people. On the business side, too, we need someone who's been doing ad sales for 10 years. Our job requirements have gotten very specific. We no longer believe that "it's okay if this guy doesn't work out in this role because we can move him." Now we aren't looking for best athletes.
>
> However, it's hard to find great specialists! A big lesson was, like with great engineers, once you start doing your own ad sales, always hire any great ad-salespeople who come along because it's hard to find them. We didn't start looking until we needed someone, and then it was way too late; it took us a long time to hire them. As a result, our sell-through rates were lower than they should've been. You can take a stem cell and have them kick off an ad-sales group, but when you get into the nitty gritty of working with 20 New York ad agencies, you need someone who knows the players. It would take stem cells longer; we were ramping up so fast, it would take a stem cell a long time to figure out the ins and outs of all those agencies.

> With our early finance hire, it was like he had played wide receiver in college and we thought he could play defensive back in the pros, so we drafted him. Then, we didn't use him as a defensive back and he ended up being only the third-best wide receiver. Oh well! Early on, we chose flexibility over getting the best person for the specific role, but that changed now.

These changes affected FeedBurner's culture. Costolo explained:

> As the tech and ad-sales teams grew, their cultures became more about expertise. In technology, the people who fit in now are the guys who can crank great Java code. The person who has trouble fitting in is the one who is less competent; even if he's flexible and his personality fits, the team would not hang out with him as much. It's the same in ad sales.
>
> We now had someone in ad operations who was very focused on, "This is my job title" and "These two people report to me." I think that title stuff is organizational suicide in the early days, so I'm adamantly opposed to people who negotiate titles. But now, pieces of the organization that we wanted to be very fluid, other people wanted to force them into having more structure. Stem cells couldn't care less about titles, but the specialists did care.
>
> The other functions are different; they're still like we were in the beginning. In publisher acquisition, ad operations, marketing, we want to get the right people who are cultural fits, maybe are even right out of college. "This guy's great, we like his skill set, he can do a lot of different things, let's start him off in publisher acquisition and then have him do a bunch of other things." Also with finance, operations, and business development, the culture is still about being able to juggle lots of things at once, being able to multitask.

Looking ahead to the next inflection point, Costolo anticipated that when FeedBurner passed 40 people, it would have to hire support people to keep the organization operating smoothly: "It's like when your family grows to the point where you have to count how many kids you took to the store. It's starting to feel like that now. We're also starting to bring in specialists who aren't good at setting up their own email and doing things on their own, so we'll have to bring in the next layer of 10 HR and IT support people to give them more hand-holding."

Costolo also anticipated the need to formalize more processes. "But," he acknowledged, "I don't have the mentality needed to develop training processes, performance evaluation, and so forth."

Bites from Big Players

As the "Web 2.0" market heated up, Costolo noticed that startups were beginning to gain negotiating leverage. For instance, he noticed that, as part of many financing rounds, founders were increasingly able to get "partial founder buyouts" (PFBs)—i.e., to cash out some of their equity. "They'd tell their VCs, 'I'm going to do the financing round instead of selling to a big company, but to de-risk it for me, I want to take $5 million off the table.' The investors have to either offer them that term or they'll sell. They get a best-of-both-worlds term sheet." When Costolo mentioned a PFB to his VCs during their discussions about the upcoming C-round, the VCs said that they'd prefer not to do a PFB, but that they would if the team insisted on one.

Even so, Costolo was not keen on having a PFB. "To me, if we wanted to sell common stock, we'd sell the company instead of raising another round! I want to stay in because I feel there's a lot more stock value to be built." However, Costolo knew that some of his co-founders would find a PFB very attractive: "Eric and I are always more willing to take more risk, leave it all out there, keep going. Steve and Matt are more like, 'Let's not look back on this with regret. Let's take something off the table.'" Many of the non-founding employees who held equity would probably feel likewise.

At this point, the two sides of the business, publisher recruiting and ad sales, began to diverge at an increasing rate. The amount of advertising sold was not keeping pace with the amount of new publishers joining each day, causing the ad dollars per publisher to fall. "We aren't scaling the ad side as well as we should; we are scaling ads linearly while publisher growth is exponential. We're hiring more sales guys but still not keeping pace. Publishers are complaining, 'You say you're signing up a lot more ads, but I made less in October than I did last June!'"

In the fall of 2006, potential acquirers began to show up again. Costolo explained:

> AOL, Google, and Yahoo! have seen that we've locked up the market with publishers. They have the opposite problem from the one we have: They have plenty of advertisers but they can't find enough publishers to take them. Now, the dynamics are starting to be on our side. Acquirers are starting to value the number of publishers, so their offers are getting better. We are still sticking to our guns on valuation and price, telling them, "big strategic opportunity, the future of content distribution, yada yada." AOL, Yahoo!, and Google are placing a high value on the market share we have, which is orders of magnitude higher than our nearest competitor. At the same time, though, we are starting to see some chinks in our own armor on the publisher side, with the pressure to sell more ads.

Google offered a cash deal with additional two-year cash lockups. Offers for a C-round of financing began coming in from investors, with a slightly lower valuation than in Google's acquisition offer. If FeedBurner were to raise a new VC round, the VCs would own more than 50% of the venture, and the board would be composed of three VCs, the two founders, and two independent directors. Costolo was getting pressure from the board to do the C-round instead of selling the company. However, some of the founders disagreed. Because of their "engineering bent," Lunt and Olechowski were very excited about Google's offer. For his part, Costolo did like the fact that Google was the most innovative, entrepreneurial, and culture-focused of the potential acquirers, but added, "I'm not an engineer any more. To me, best price wins." He continued:

> With the different risk profiles within the founding team, some are ready to do the deal, while others say, "Let's tell them to go to hell. We need 25% more." You might think you're all going to be on the same page, but when the real number comes in, people can rationalize taking lower: "That's a good offer, and we're fine with working there, so let's take it."
>
> The total number is right, the board wants to do it, but one early employee has a funky option deal that won't work out with the way the deal is done so he doesn't want it. But Google is saying, "That person's a key employee," so that person can hold the deal hostage. Do I give the person extra money and buy him off?

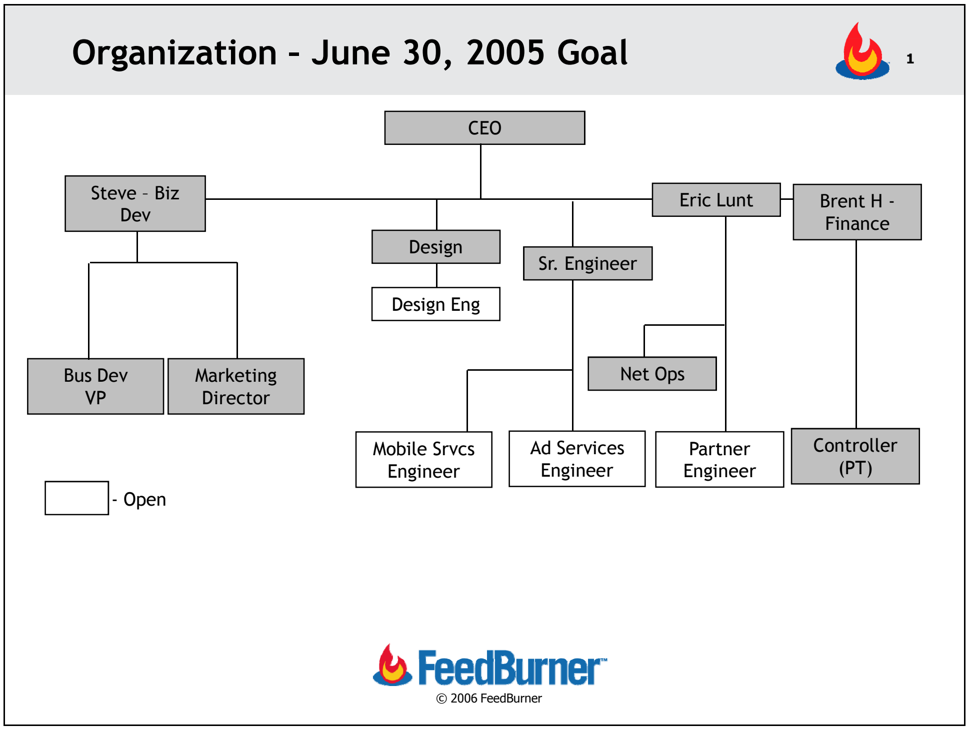
Costolo weighed his alternatives and tried to figure out what he and his team should do.

Exhibit 1 Details on the Four Ventures

Venture	Founders *(Key non-founders)*	Business Description	Outcome	Number of Employees at Exit
Burning Door	Dick Costolo Marc Rettig *(Eric Lunt)*	Website/software consulting and design firm	Merger / acquisition to form DKA	3
Digital Knowledge Assets (DKA)	Dick Costolo Eric Lunt 2 other founders *(Steve Olechowski)* *(Matt Shobe)*	Collaboration and publishing software company	Acquisition ("Our CEO pulled a rabbit out of his hat")	20
Spyonit	Dick Costolo Eric Lunt Steve Olechowski Matt Shobe	Consumer Internet business (main product: alert systems for consumers)	Sale to 724 Solutions	16
FeedBurner	Dick Costolo Eric Lunt Steve Olechowski Matt Shobe	Feed management and monetization for publishers	TBD	Currently 38

Source: Authors.

Exhibit 2 Organization Charts, June 2005–February 2006



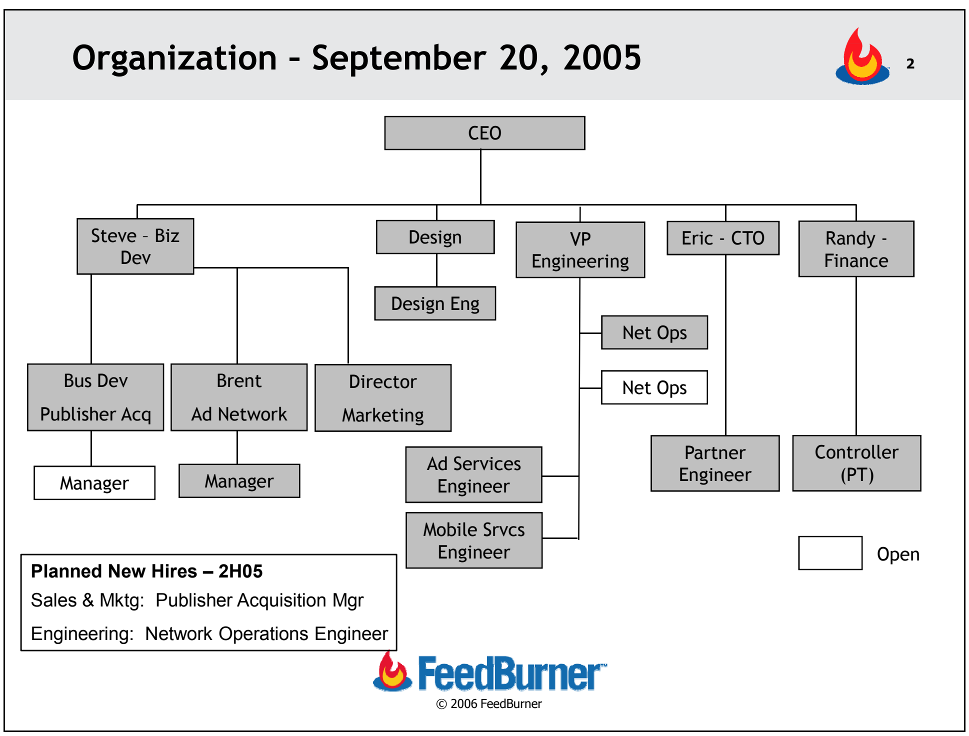
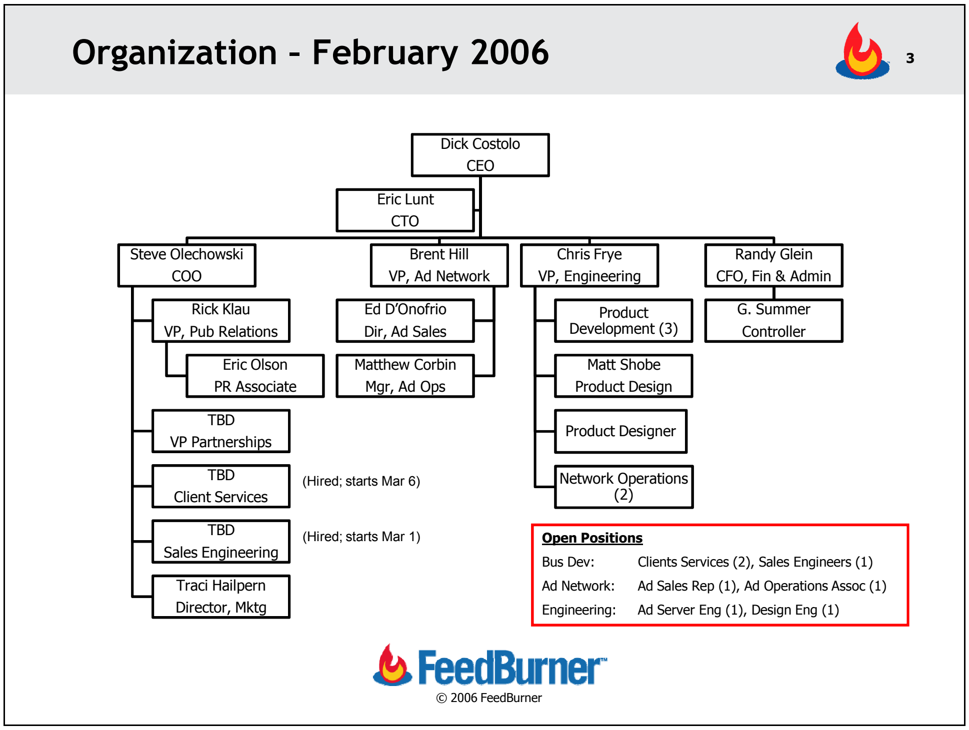
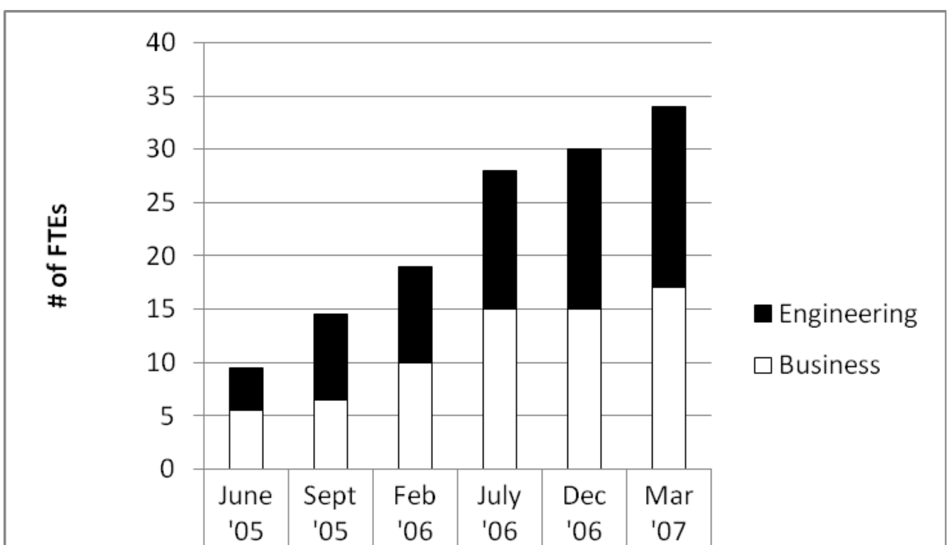


Exhibit 2 (continued)



Source: Company.

Exhibit 3 Growth in Number of Employees



	June '05	Sept '05	Feb '06	July '06	Dec '06	Mar '07
Engineering	4	8	9	13	15	17
Business	5.5	6.5	10	15	15	17

Source: Company.