Surprising facts from THE FOUNDER'S DILEMMAS:

ANTICIPATING AND AVOIDING THE PITFALLS THAT CAN SINK A STARTUP

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Based on a decade of deep research that includes data on 10,000 founders and more than two dozen "inside" case studies, *THE FOUNDER'S DILEMMAS* gives a groundbreaking analysis of the decisions faced by a startup's founding team, early hires, and investors.

Entrepreneurs embarking on their startup journey have had no roadmap to follow—until now. What are the costly mistakes that founders should avoid and can such mistakes be undone? How can founders expect the best while preparing for the worst? What are the trade-offs founders must negotiate between building wealth versus retaining control of a startup? To help entrepreneurs achieve founding success, *THE FOUNDER'S DILEMMAS* arms them with real knowledge of common and significant pitfalls.

Founders usually have to choose between becoming "Rich" versus remaining "King": Founders who bring in outside resources imperil their control of the startup; conversely, founders who resist imperiling their control often fail to attract the resources necessary to realize the full potential of the startup. Founders who kept control of both the CEO position and of the board of directors had equity stakes that were only 50 percent as valuable as the stakes held by founders who had brought in outside resources and given up control of both the CEO position and the board of directors.

Your success as founder-CEO gets you fired: Founder-CEOs who succeed at building a fast-growing startup tend to be fired even more quickly than slower-growth CEOs. There are two main reasons. First, the fast-growing startup outstrips their skills even faster than if they had achieved moderate growth. Second, the fast growth is often fueled by the raising of outside capital, which shifts the power within the board away from the founder and toward the outside investors.

More than 50 percent of founders are replaced as CEO by the time the startup raises its third round of financing: During each round of financing, as a condition of their investment, investors can demand that the founder-CEO be replaced. After the first round, 25 percent have been replaced; after the second round, 38 percent have been replaced; after the third round, 52 percent *have* been replaced.

In 73 percent of founder-CEO replacements, the founder was fired rather than voluntary stepping down: Only 27 percent of founder-CEO replacements were initiated by the founder-CEO. The other 73 percent were initiated by the board of directors or by a similar party. The latter type of succession is much more fraught with peril for the startup, increasing the likelihood that the transition to a new CEO will be a rocky one.

Firing yourself enables you to remain more involved with your startup: Founder-CEOs who initiate their own replacement remain on the startup's board of directors 96 percent of the time, and remain in an executive position 37 percent of the time. In contrast, when the board initiates the succession, those percentages drop to 60 percent and 24 percent, respectively.

People problems are the leading cause of failure in high-potential startups: Around 65 percent of the failures of high-potential startups are due to "people problems"—the interpersonal tensions within the team.[1] These problems consistently fall into three categories: Relationship problems, Role and decision-making problems, and Reward problems (e.g., tensions over equity splits). Within each category, the most common choices are often the most hazardous.

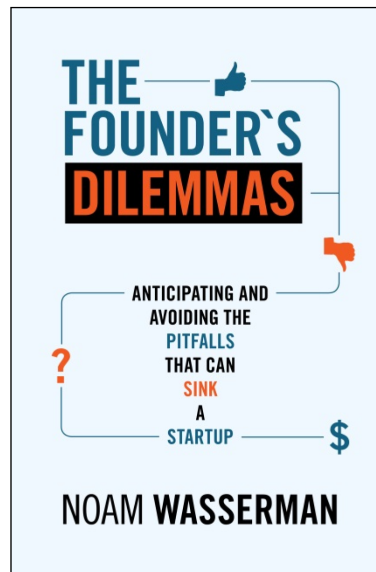
Entrepreneurial strengths often become Achilles heels: Early on, a founder's *passion* for the idea, *confidence* in its prospects and in his or her own abilities, and *attachment* to the startup can be the founder's greatest strengths. As the startup evolves, though, each of those strengths can become a major liability as the founder refuses to adjust the idea, underestimates the need for additional resources or skills, and makes decisions that harm the startup.

[1] Gorman and Sahlman (1989) suggested that people problems caused 65 percent of failures within venture-capital portfolios. Kaplan and Stromberg (2004) showed that 61percent of VCs' anticipated risks were because of people problems.

Founding with friends or family is a common but high-risk proposition: In contrast to their greatest hopes when they cofound together, teams of friends or relatives are the *least* stable of all types of founding teams, even less stable than teams of strangers/acquaintances. Within a founding team, each additional social (i.e., friend or family) relationship increases the likelihood of a cofounder leaving the team by almost 30 percent.

It is perilous to split equity ownership early and statically: 73 percent of founding teams split the equity (i.e., the ownership of the startup) within a month of founding, and more than 50 percent of all teams fail to include any mechanisms for adjusting the split if things change. Yet, nearly all startups will have a major change in strategy, business model, or cofounder involvement that makes that initial equity split problematic or disastrous.

Raising the first round of financing heightens founding-team instability: When a startup raises a round of financing, it finally has a stamp of approval that it has real potential, and finally has resources to invest in the product and to pay its employees. We would therefore expect the founders to want to remain involved even more than they did before. Yet, raising a new round of financing dramatically *increases* the chances that a founder will leave. Sometimes, this happens because the investor triggers a realignment of equity within the team, destabilizing the team. Other times, completing a round of financing can trigger a demotion for founders if the investors fear that those founders are not capable of keeping up with the demands of the startup, increasing the chances that those founders will leave.



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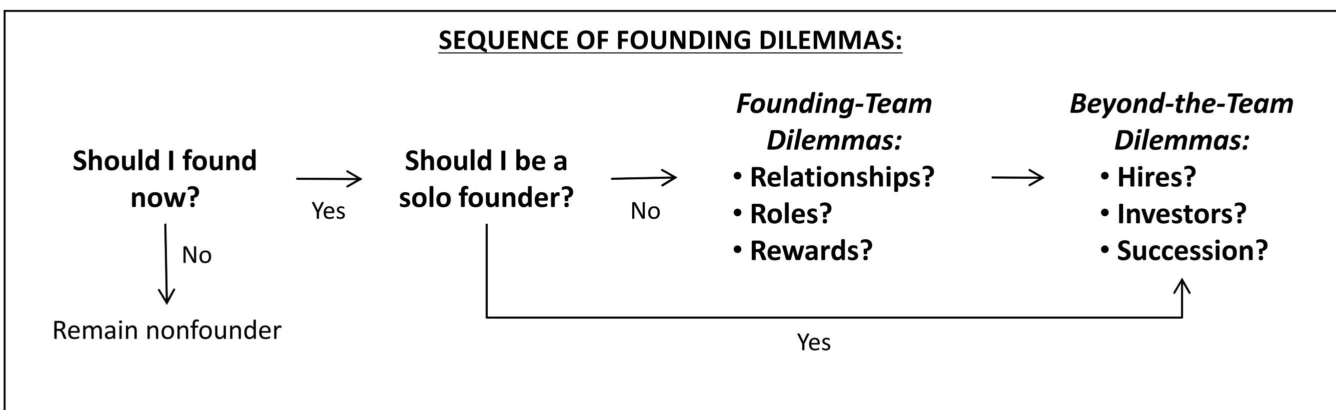

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