Module 5: RAISE OF FUNDING AND GOVERNANCE

Supplemental Material: Startup and Founder Conflict

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4 areas that can lead to startup failure

1. Motivation
2. Communication
3. Product
4. Governance & Procedures

Founder’s Agreements

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4 areas that can lead to startup failure

Motivation:

- Starting a business for the wrong reason ("startups are cool")
- Not building a product you like/care about
- Not caring about the users for whom you are building a solution
- Choosing co-founders that you don't know well (because of qualifications, etc.)

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4 areas that can lead to startup failure

Communication:

- Not having transparent conversations (performance, goals, roles) leads to resentment
- Not listening
- Postponing/ignoring conflict
- Too much conflict, stonewalling
- Not enough substantive feedback
- Over-criticizing/defensiveness

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4 areas that can lead to startup failure

Product

- Not launching (fear of not being ready) – delay causes stagnation
- Not using analytics/measuring user behavior
- Having no idea where your first users will come from (don’t you know *anyone* who has the problem that you chose to solve?)
- Prioritization (flashy stuff instead of product)

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4 areas that can lead to startup failure

Governance & Procedures

- Not defining roles & responsibility
- No structure for decision-making
- Not resolving commitments & contributions

- The above can be handled with a Founders Agreement

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Founders Agreement: Roles & Responsibilities

Define who does what, and the titles for each:

- Clearly establish expectations about responsibilities and role divisions; define the functional aspects of each position & title, and distribute responsibilities. This can ensure accountability.
- Often, each co-founder wants to be CEO. You can stipulate that roles will be reevaluated periodically, such as every six months, and, if necessary, redefine titles and roles to reflect changing needs.
- Delineating titles and roles helps provide structure by distributing responsibilities.

Questions to Consider about Roles & Responsibilities:

- What are the titles of each founder?
- Do you have clearly defined responsibilities for each role?
- Have you created limits for roles?
- How will you allow for change as founders' roles change over time?

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Condensed from: https://www.hbsaccelerate.org/people/founding-team/key-terms-to-include-in-a-founders-agreement/

Founders Agreement: Decision-Making Process

Establish decision-making rights: a clear delineation at the outset can help to avoid future conflict and create a culture of openness.

1. Define who holds final authority within different aspects of the business.
2. Stipulate what circumstances matter.

Founders make decisions based on their experience, roles, and expectations.
- Sometimes, perspectives don't align.
- Lacking a decision-making path can lead to conflict.

What happens if you disagree?
- How will disagreements and deadlock be resolved?
- Even if you plan to promote a collaborative culture, not all decisions should be made collectively.

Don't confuse ownership (%) with decision-making rights. It is possible for one co-founder to have a larger equity share with fewer decision rights.

Your founders' agreement should stipulate who has the right to make any given decision. It should propose a course of action if partners disagree.

For example:

A technical co-founder might set a one-year goal for developing a product, while a business-oriented co-founder might want to guarantee investors that the product will be ready in 6 months.

Who has the right to override which decision, given that decisions affect the same pool of resources?

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Founders Agreement: Contributions & Commitments

Contributions & Equity (as compensation):

- List assets such as IP, network, capital and time each co-founder invests
- How much compensation should each co-founder receive?
- Most founders opt to divide equity equally or calculate a percentage of equity split based on the contributions each co-founder makes.
- *But calculating percentages is highly subjective.*

- Calculations are often based on the founders' past contributions—which many overvalue—and expected future contributions—which are impossible to accurately predict.
- Consider the option of making the equity split a separate legally binding document.

Commitments:

- When discussing equity and decision rights, resist the common temptation to conflate the two.
- Many founders make the mistake of creating a 1:1 correlation between equity with decision rights. But this often leads to future conflict.
- The percentage of equity ownership and decision rights do not have to match. Consider structuring your FA to address equity and decision-making separately.

Questions to Consider

- Who will decide what?
- What is the time limit for decision making?
- How will you handle deadlock?
- By what method will you reach consensus when making important decisions?
- Which decisions can be made by a single person, and which need consensus by both/ all founders?
- Did you separate equity from decision rights?
- Who will represent the company on the Board?
- Will founders who don't have Board representation receive observer rights?
- How will you allocate equity?

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Founders Agreement: Contributions & Commitments

Time:
- Determine what is expected of each person in their respective role. Define what a “full-time,” “half-time,” etc. actually mean.

Intellectual Property (IP)
- When you and your co-founders iterate on an idea and develop a business plan or begin to build a product or a platform, you are creating intellectual property (IP).
- Your startup should secure IP rights not only from your co-founders but from your employees, consultants, and contractors.
- Stipulate that whatever IP is produced for your startup belongs to the company, not to the individuals who developed it.

Network
- Some founders have a strong network they are willing to share that would increase the chances of a company succeeding. Others feel reluctant to share their network initially, while they’re unsure of the future success of the company.
- State a clear policy and expectations for each founder.

Capital & Confidentiality
- State whether any founder contributed personal funds to the venture and describe the terms for capital usage.
- Include a standard confidentiality clause, with non-disclosure terms.

Questions to Consider
- How much time will each founder commit to the startup and for what duration?
- Did you specify the number of hours that you consider full-time?
- What is each founders’ obligation to the company, in light of future external opportunities that could conflict with current roles and expectations?
- Did you include an IP provision?
- What is each founder’s financial obligation to the company?
- Did you record any capital contributions by a founder, and terms of usage?
- Will founders share networks and connections?

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Founders Agreement: Contributions & Commitments

Contingencies

Even with a thoughtfully crafted founders' agreement, unpredictable issues will arise. Your FA can provide provisions that help establish a process for dealing with unexpected scenarios, such as if a partner leaves. Founders often don't feel the need for contingency provisions, but at a minimum, including a vesting period for all co-founders can protect your startup and your relationship.

Vesting

- Instead of receiving equity rights instantaneously, vesting defines the criteria co-founders must meet to earn their equity.
- Commonly, vesting stipulates that founders must either work for a set period of time or meet certain milestones before their equity becomes available.
- Vesting provisions help ensure that co-founders will remain actively involved in and committed to the startup.
- The most common time-based vesting term occurs quarterly over four years, with a one year "cliff". That means that the vesting schedule will not be enforced for the first year.
- Most founders opt to include a time-based vesting schedule, although time-based vesting only measures the quantity of time, not the quality of work.

Questions to consider

- Did you include time-based or milestone-based vesting terms?
- What happens if a founder leaves or is asked to leave?
- If a founder leaves do other founders have the right to buy unvested shares or do these go back to the common pool?
- What happens if a founder wants to sell part of his or her shares?
- How will you handle the acquisition or sale of the company?
- Will you create an option pool to attract new hires or give additional grants to the existing team? If so, how much of the equity will you reserve for that?

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