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The entrepreneurial team

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‘In individuals madness is a rarity, but in groups, it is the rule’

Nietzsche

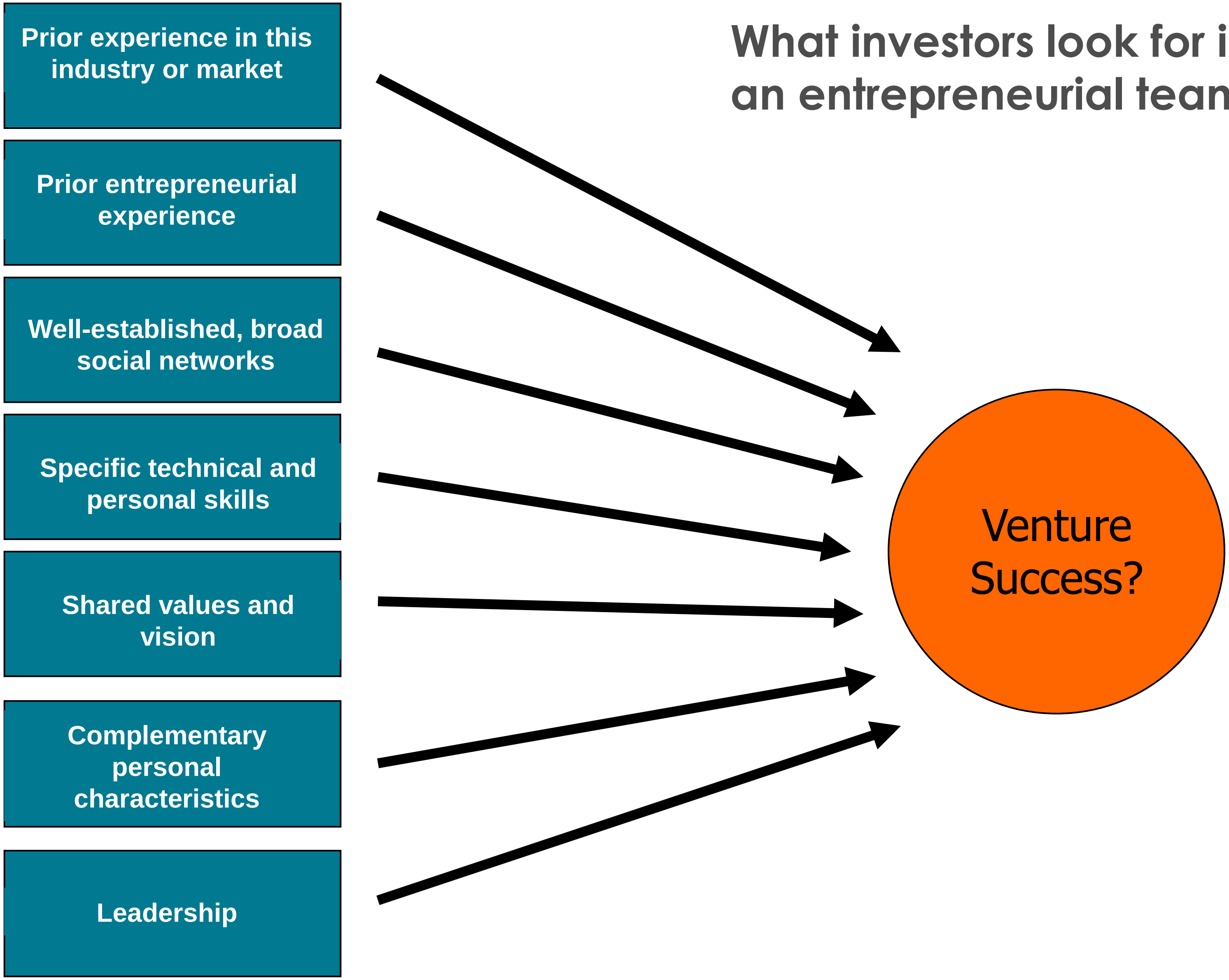
In this session:

- The core competences of entrepreneurial teams
- Recruiting and selecting team members
- Dividing founders’ equity
- What goes wrong…?

Most high potential new ventures require a team

- Almost impossible to raise formal equity without a team
- Alone, you won't have enough time!
- Mix/depth of functional skills
- Diversity of perspectives – superior decision making(?)
- Management of complexity
- Contribution to your capital mix
- Social and psychological support

What investors look for in an entrepreneurial team



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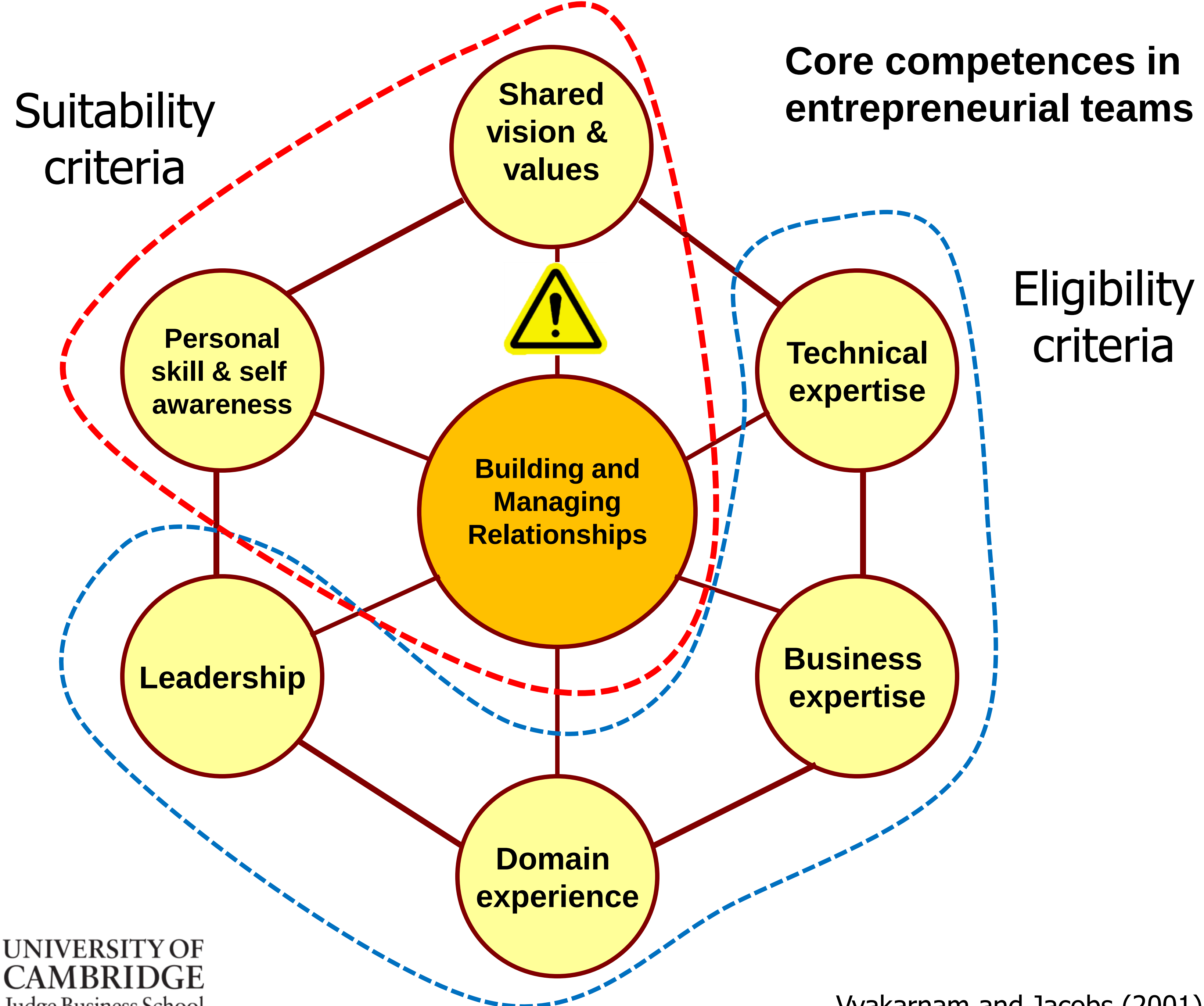

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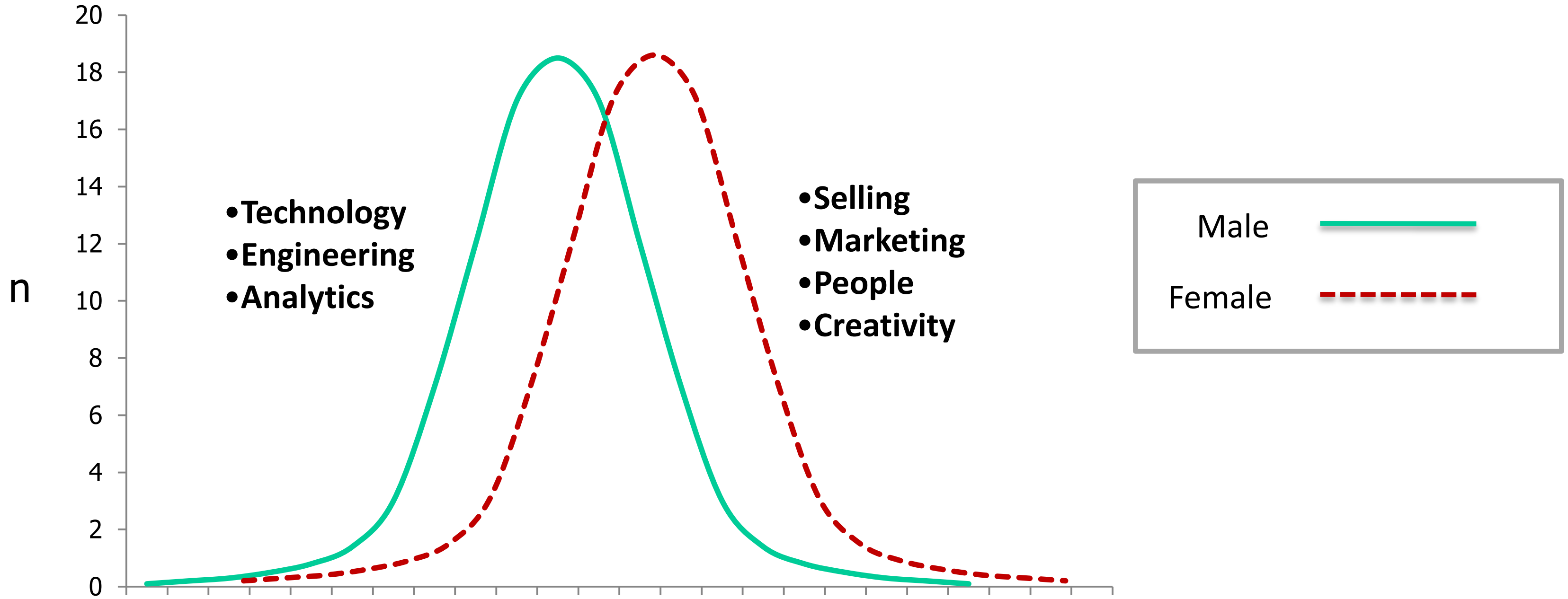
Vyakarnam and Jacobs (2001)

Human behaviour and the AQ-EQ spectrum

Dislike un-planned change Obsessive interest in facts Socially ‘awkward’ Few, but deep, friendships Introverted	↔	Tolerant of ambiguity Interest in relationships Socially ‘adroit’ Many friendships Extroverted



Autistic Quotient ↔ Emotional Quotient

Left Brain		**Right Brain**
Logical Sequential Rational Analytical Objective Looks at parts	↔	Random Intuitive Holistic Synthesizing Subjective Looks at wholes

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Based on the work of **Simon Baron-Cohen**

Building your team

Potential rewards > Perceived risks

Remember the implications of 'Prospect Theory'

"Losses hurt more than gains feel good…!"

Inducements - Persuading people to join the team

Barriers (risks)

- Family responsibilities
- Commitment to career
- Current financial commitments
- Attitude towards uncertainty
- Fear of failure
- Fear of financial loss

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Material rewards:

- ✓ Equity in new venture
- ✓ Salary & *bonuses*
- ✓ The 'toys' (if we 'make it big')

Non material rewards:

- ✓ Flexibility – part time to begin with
- ✓ Personal achievement
- ✓ Working relationships
- ✓ Recognition
- ✓ Control
- ✓ Prestige, power, challenge, fun

Non-material rewards are often the most powerful

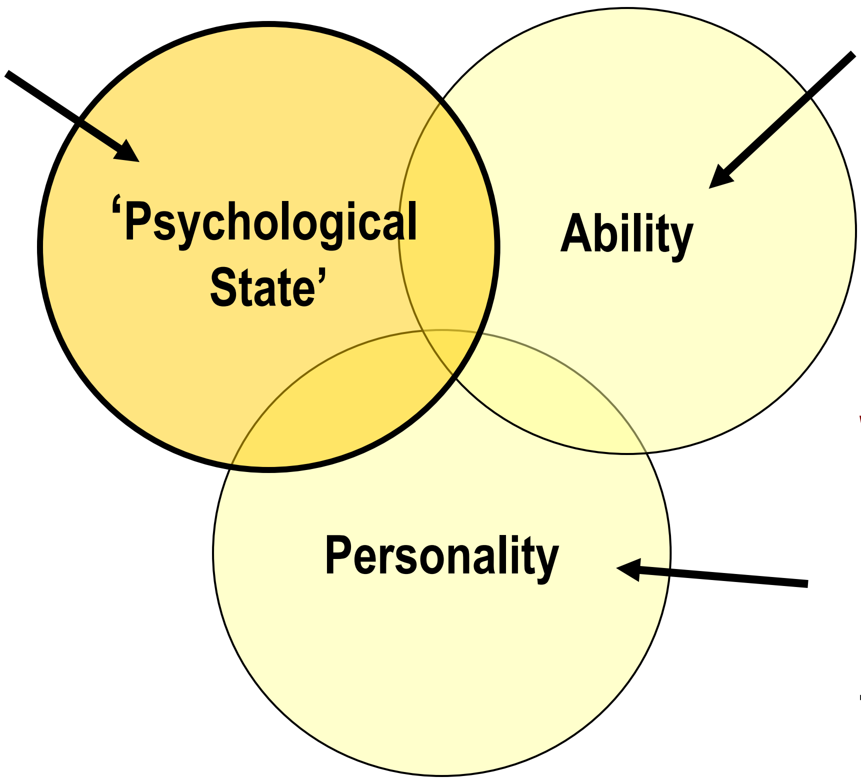
The 'black arts' of selection….3 key questions

Will they do the job?

Depth interviewing
References
Trial engagement
Specialist instruments

Can they do the job?

CV
Interview
References
Aptitude tests
Trial tasks
Trial engagement



Will they fit in?

Informal/team interview
References
Psychometric assessments
Trial engagement

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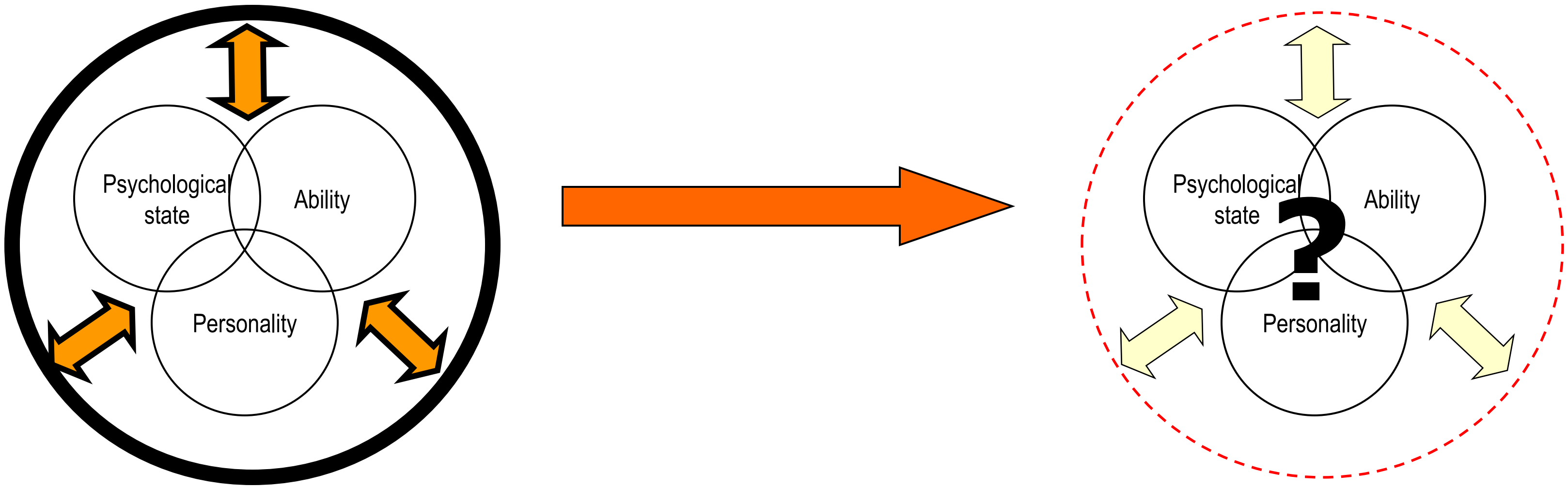
Problems associated with predicting behaviour

Current environmental context | **Context of the new venture**



The person you see at interview!

Probable change in Psychological state…and behaviour

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Equity and the founding team

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A cautionary word about equity

- Novice entrepreneurs are prone to parting with too much equity too easily
- Equity is sold or used to reward for <u>value created</u> it is not ‘given away’
- What constitutes an appropriate reward?
    - **NED or chairman = 1 to 2% (+/-)**
    - **Full time (non-founding) director = 5% (+/-)**
- All founder and NED shares should have a vesting schedule
- The Enterprise Management Incentive Scheme (EMI) is for employees only!
- Remember that a share option scheme (EMI) is an important motivator for employees and that this can account for up to 10-15% of the equity in the business

CONSERVE YOUR EQUITY

Share vesting

- Share vesting protects the interests of the business and investors should someone become a ‘bad leaver’ during the vesting period (usually 4 years)
- It enables the company to buy back all, or a proportion of the leaver’s shares for the nominal (par) value of those shares
- This obviously excludes shares bought for cash or issued in return for assigned IP

A typical share vesting schedule

Founder leaves during year	Company buys back	Equity entitlement
1	100%	Zero
2	75%	25%
3	50%	50%
4	25%	75%
5	Zero	100%

‘The cliff’

When does vesting apply?

‘Good Leaver’ clause

- Retirement
- Redundancy
- Injury
- Receive market value of shares

‘Bad Leaver ‘ clause

- Resignation
- Gross misconduct
- Non-performance
- Sell shares back at ‘par’ value
- Get back money invested.. But not ‘sweat equity’

You need this in your Shareholder Agreement….

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‘Slicing the pie…’

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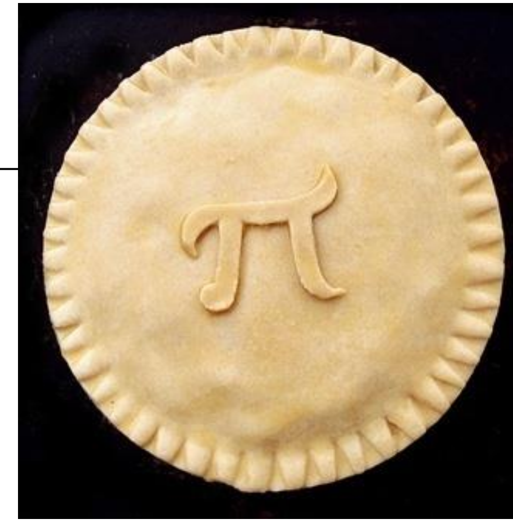
Deciding who gets what..

The law of distributive justice:

‘Who gets what should reflect anticipated and actual contributions to the ultimate success of the venture’

So…How do we decide?

Slicing the founders' pie…



Factors to consider:

- The idea (usually over weighted)
- The core technology
- Domain expertise
- Commitment and risk
- Role and responsibilities
- Sweat equity
- Social capital
- Etc, etc…

Stage 1: Think carefully about the drivers of success in your new venture. Agree a weighting (1-10) for each of these

	Weigh
Idea and technology	6
Domain expertise	3
Commitment and risk	7
Responsibilities	6
Sweat equity	2
Social capital	2

Stage 2: Consider the past, current and (likely) future contributions of each founding team member to the ultimate success of the company. Score these from 1-10.

	Weight	Founder 1	Founder 2	Founder 3	Founder 4
Idea and technology	6	10	0	3	0
Domain expertise	3	2	3	4	8
Commitment and risk	7	2	2	4	10
Responsibilities	6	5	4	3	8
Sweat equity	2	4	2	2	7
Social capital	2	0	10	4	9

Stage 3: Multiply the weightings by the contributions to calculate the 'fair' share of the pie….

	Weight	Founder 1	Founder 2	Founder 3	Founder 4
Idea and technology	6	60	0	18	0
Domain expertise	3	6	9	12	24
Commitment and risk	7	14	14	28	70
Responsibilities	6	30	24	18	48
Sweat equity	2	8	4	4	14
Social capital	2	0	20	8	18
Total Points		118	71	88	174
% of Total		26.2%	15.7%	19.5%	38.6%

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What goes wrong?

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Personality types and cognitive biases

- **STs** are prone to **anchoring** (failure to search for additional information and a tendency to ignore qualitative information presented by others) and to **functional fixedness** (avoidance of risk and reliance on standard operating procedures).

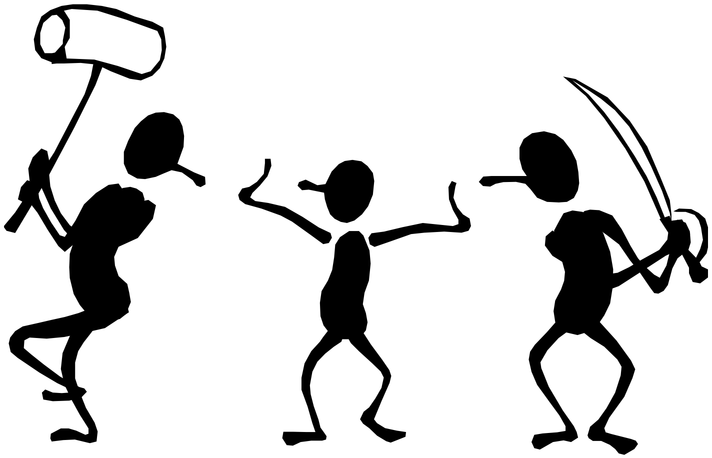
- **SFs** show a tendency towards the **availability bias** (focusing on heavily value laden or emotional information, even after others present more objective information)

- **NTs** are prone to **perseverance** (staying with an initial viewpoint on issues after others have introduced disconfirming or contradictory information) and to **positivity** (heavily emphasis on opportunity and minimizing the threats of a particular course of action).

- **NFs** are more likely than other types to display the **vividness bias** (focusing heavily on idiosyncratic or memorable information, even when others present more quantitative information).

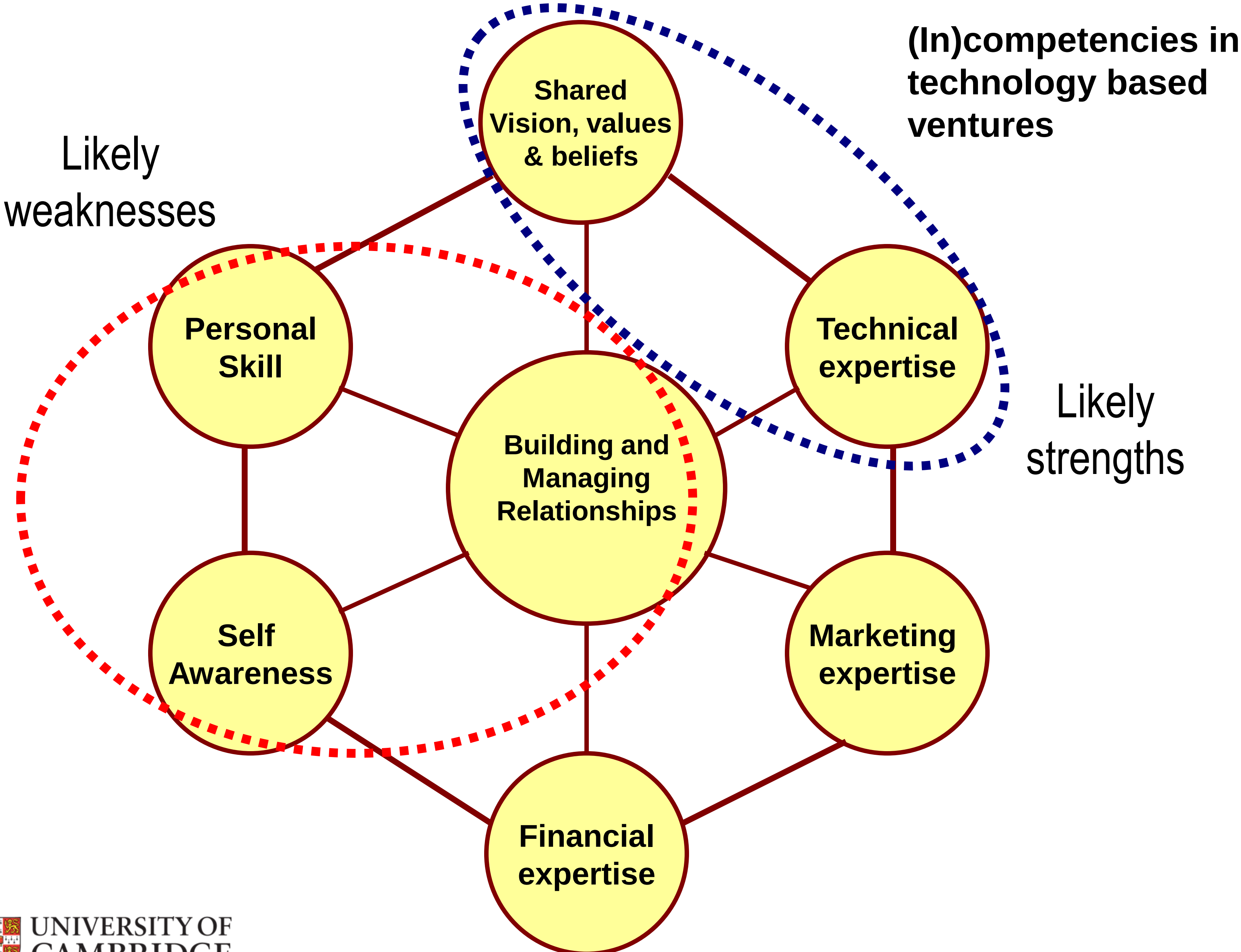
Source: Haley & Stumpf (1989)

Failure to establish norms relating to conflict



- **Cognitive conflict** - issue/task related..
- **Affective conflict** - getting personal..
- **Role conflict** - contradictory/incompatible messages..

Moderate levels of cognitive conflict are associated with better decisions



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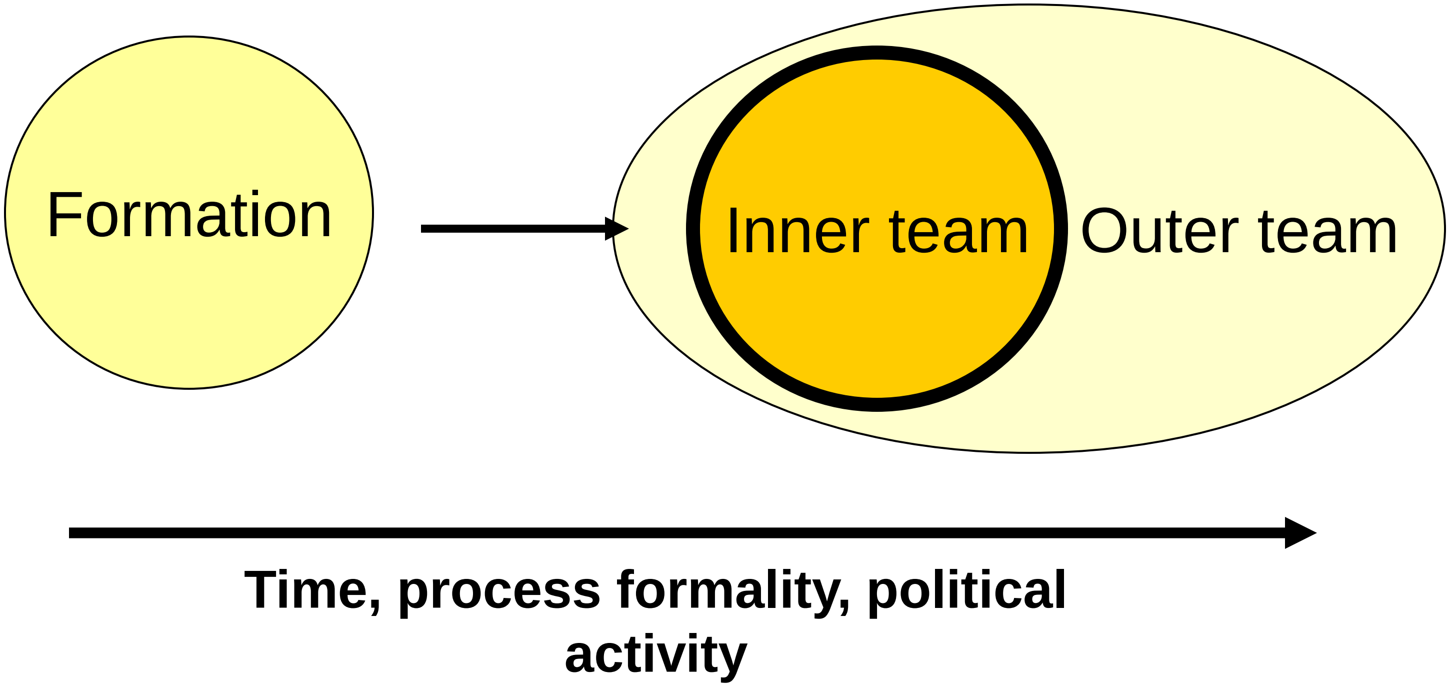
Us and them….



After Vyakarnam et al 1999

Team Pathologies

- **Risky shift** – groups tend to make more risky decisions than the average of their members' decisions. They also tend to be less creative.
- **Satisficing behaviour** – a tendency of groups to make minimally acceptable decisions.
- **Groupthink** – Groupthink may occur in cohesive groups when achieving consensus becomes more important than the quality of the decision.
- **Egocentric behaviour** – senior individuals may refuse to consider opinions or accept knowledge that runs counter to their own.
- **Status effects** – the views of senior executives tend to be valued and acted upon disproportionately
- **Communication bias** – differences in ability to communicate tend to influence the weight given to contributions.

Building an entrepreneurial team - Key points

- Select members for their eligibility *and* their suitability
- Pay ***very close attention*** to values, goals and commitment
- Use external resources to fill gaps (advisory board, NEDs, professionals)
- Don't part with equity before value has been added/created, use bad leaver clauses and share vesting
- Take the best legal advice when drawing up your shareholder agreement
- Slow to hire…..quick to fire, particularly early on!

'Hire in haste…repent at leisure'