Cambridge Judge Business School

The entrepreneurial team

Simon Stockley
Senior Teaching Faculty in Entrepreneurship
‘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

- Prior experience in this industry or market
- Prior entrepreneurial experience
- Well-established, broad social networks
- Specific technical and personal skills
- Shared values and vision
- Complementary personal characteristics
- Leadership

Venture Success?
Suitability criteria

- Personal skill & self awareness
- Leadership
- Domain experience

Core competences in entrepreneurial teams

- Shared vision & values
- Technical expertise
- Business expertise

Eligibility criteria

 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

n
0 2 4 6 8 10 12 14 16 18 20

Autistic Quotient

Male
Female

Technology
Engineering
Analytics
Selling
Marketing
People
Creativity

Left Brain
Logical
Sequential
Rational
Analytical
Objective
Looks at parts

Right Brain
Random
Intuitive
Holistic
Synthesizing
Subjective
Looks at wholes

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

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
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 value created 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

<table>
<thead>
<tr>
<th>Founder leaves during year</th>
<th>Company buys back</th>
<th>Equity entitlement</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>100%</td>
<td>Zero</td>
</tr>
<tr>
<td>2</td>
<td>75%</td>
<td>25%</td>
</tr>
<tr>
<td>3</td>
<td>50%</td>
<td>50%</td>
</tr>
<tr>
<td>4</td>
<td>25%</td>
<td>75%</td>
</tr>
<tr>
<td>5</td>
<td>Zero</td>
<td>100%</td>
</tr>
</tbody>
</table>
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....
‘Slicing the pie...’

Simon Stockley
Senior Teaching Faculty in Entrepreneurship
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

<table>
<thead>
<tr>
<th></th>
<th>Weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>Idea and technology</td>
<td>6</td>
</tr>
<tr>
<td>Domain expertise</td>
<td>3</td>
</tr>
<tr>
<td>Commitment and risk</td>
<td>7</td>
</tr>
<tr>
<td>Responsibilities</td>
<td>6</td>
</tr>
<tr>
<td>Sweat equity</td>
<td>2</td>
</tr>
<tr>
<td>Social capital</td>
<td>2</td>
</tr>
</tbody>
</table>
**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.

<table>
<thead>
<tr>
<th></th>
<th>Weight</th>
<th>Founder 1</th>
<th>Founder 2</th>
<th>Founder 3</th>
<th>Founder 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Idea and technology</td>
<td>6</td>
<td>10</td>
<td>0</td>
<td>3</td>
<td>0</td>
</tr>
<tr>
<td>Domain expertise</td>
<td>3</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>8</td>
</tr>
<tr>
<td>Commitment and risk</td>
<td>7</td>
<td>2</td>
<td>2</td>
<td>4</td>
<td>10</td>
</tr>
<tr>
<td>Responsibilities</td>
<td>6</td>
<td>5</td>
<td>4</td>
<td>3</td>
<td>8</td>
</tr>
<tr>
<td>Sweat equity</td>
<td>2</td>
<td>4</td>
<td>2</td>
<td>2</td>
<td>7</td>
</tr>
<tr>
<td>Social capital</td>
<td>2</td>
<td>0</td>
<td>10</td>
<td>4</td>
<td>9</td>
</tr>
</tbody>
</table>
**Stage 3:** Multiply the weightings by the contributions to calculate the ‘fair’ share of the pie.

<table>
<thead>
<tr>
<th></th>
<th>Weight</th>
<th>Founder 1</th>
<th>Founder 2</th>
<th>Founder 3</th>
<th>Founder 4</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Idea and technology</strong></td>
<td>6</td>
<td>60</td>
<td>0</td>
<td>18</td>
<td>0</td>
</tr>
<tr>
<td><strong>Domain expertise</strong></td>
<td>3</td>
<td>6</td>
<td>9</td>
<td>12</td>
<td>24</td>
</tr>
<tr>
<td><strong>Commitment and risk</strong></td>
<td>7</td>
<td>14</td>
<td>14</td>
<td>28</td>
<td>70</td>
</tr>
<tr>
<td><strong>Responsibilities</strong></td>
<td>6</td>
<td>30</td>
<td>24</td>
<td>18</td>
<td>48</td>
</tr>
<tr>
<td><strong>Sweat equity</strong></td>
<td>2</td>
<td>8</td>
<td>4</td>
<td>4</td>
<td>14</td>
</tr>
<tr>
<td><strong>Social capital</strong></td>
<td>2</td>
<td>0</td>
<td>20</td>
<td>8</td>
<td>18</td>
</tr>
<tr>
<td><strong>Total Points</strong></td>
<td></td>
<td>118</td>
<td>71</td>
<td>88</td>
<td>174</td>
</tr>
<tr>
<td><strong>% of Total</strong></td>
<td></td>
<td>26.2%</td>
<td>15.7%</td>
<td>19.5%</td>
<td>38.6%</td>
</tr>
</tbody>
</table>
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).

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.
Personal Skill
Self Awareness
Financial expertise
Marketing expertise
Technical expertise
Shared Vision, values & beliefs
(In)competencies in technology based ventures
Building and Managing Relationships

Likely weaknesses
Likely strengths
Us and them….

Formation → Inner team → Outer team

Time, process formality, political activity

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’