RESEARCH & IDEAS

Rich or Royal: What Do Founders Want?

Q&A with: Noam Wasserman
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Executive Summary:

It's a fundamental tension many entrepreneurs face, the conflict between wanting to become rich and wanting to keep control of their new company. Few can have both. Professor **Noam Wasserman** discusses his research into the motivations of entrepreneurs and the people who invest in them. Key concepts include:

- Entrepreneurs are often motivated by the potential of money and control, but very few ever achieve both.
- A fundamental tension between "rich and regal" starts to develop as entrepreneurs look to attract resources to grow their ventures.
- Investors need to understand the motivations of the entrepreneurs they back to make sure goals are aligned.

What motivates entrepreneurs? Money? Control? In truth, some entrepreneurs are expecting to get rich. Others want to grow and control a new venture. But most would probably answer: "both."

The problem, as Harvard Business School assistant professor Noam Wasserman sees it, is that very few entrepreneurs can achieve both—the Larry Ellisons of the business world are few and far between. In fact, there is a fundamental tension between the money side and the control side—getting rich often means selling control to investors; keeping control reduces the payday.

Wasserman addresses this paradox in a recent paper called "Rich versus King: The Entrepreneur's Dilemma," an early draft of which was featured in the Best Paper Proceedings of the 2006 Academy of Management Conference and the 2005 Babson-Kauffman Research Conference.

In this interview, Wasserman discusses his research and suggests ways that entrepreneurs can work toward being both rich and royal.

Sarah Jane Gilbert: Tell us about the conflict entrepreneurs face when establishing a new venture between the profit motive and the control motive.

Noam Wasserman: The profit motive is one of the major motivations for becoming an entrepreneur, and the one on which past entrepreneurial research has focused, going all the way back to Adam Smith, Joseph Schumpeter, Israel Kirzner, and other pillars of economics. In my own research, I also approached entrepreneurs with the assumption that they were being driven by the profit motive.

However, early in my case writing, I began running into several decisions that founders were making that seemed to conflict with the profit motive. For instance, founders I was studying were facing the choice of remaining solo founders (and being able to keep all of their ventures' equity for themselves) versus giving potential co-founders a large share of the equity to come on board. The choices were: taking money from angel investors, who would let the entrepreneur continue controlling the board; taking money from top-tier VCs, who would take control of the board; or remaining CEO of the venture versus bringing in an experienced CEO who could build a more valuable company. The very different choices that I saw founders making regarding these co-founder, investor, and hiring decisions led me to question the centrality of the profit motive for some of these founders.

This question was bolstered by two recent papers that appeared in top economics journals, each showing that entrepreneurs as a whole *do not* make more than they could make if they were employed by others, and make significantly less than expected from a risk-return perspective. But if the profit motive is what draws people to become entrepreneurs, why don't they actually end up with higher financial returns than if they were to remain non-entrepreneurs?

Most of the founders I have studied started off wanting to become both Rich and King.

As I looked across these cases, it was evident that the profit motive was competing with other motivations, most prominently the control motive. For instance, in my "Ockham" case, founder-CEO Jim Triandiflou summed up his co-founder and investor challenges as, "The issues are about control." Even though one choice might enable him to increase his financial gains, if that choice imperiled his control of the decision making within Ockham, he was inclined to maintain control at the expense of financial gains. Likewise for executive hires. In the "Wily" case I coauthored with Henry McCance, founder Lew Cirne fully realizes that hiring a professional CEO could help Wily grow markedly, but when it becomes evident that hiring that CEO will leave Lew without control of any aspects of Wily's growth, he recoils from doing so.

Across many of the cases we teach in our first-year Entrepreneurial Manager course, the founders we study run into choices that would enable them to increase financial gains at the expense of control, and vice versa. This recurring pattern helped me realize that two major entrepreneurial motivations—the profit motive and the control motive—often competed with each other, in that maximizing one imperiled the achievement of the other.

Q: What impact do the tradeoffs between these two core motivators have on resources?

A: As I delved into the tradeoff, I realized that the conflict usually emerges at the point where entrepreneurs have to attract resources to help them grow their ventures. HBS's working definition of entrepreneurship is Howard Stevenson's assertion that entrepreneurship is "the pursuit of opportunity beyond the resources controlled." If this is correct, then most entrepreneurs, after figuring out what opportunity to pursue, are stuck with having to procure the resources they need. Getting those resources will help the entrepreneur build a more valuable company. However, getting those resources is far from a free lunch. To get co-founders, investors, hires, and others to come on board and provide you with the resources you need, you have to give up things that are worth a lot to you and to them. In new ventures, the most prominent things you have to give up are equity stakes and sharing control of decision making. Both of these have implications for how much you'll gain financially from the venture and whether you'll be able to keep control of it—in other words, whether you'll be able to achieve the profit motive versus the control motive.

Interestingly, a colleague, Richard Tedlow, pointed out to me that this choice may be a more general managerial tension that exists long after companies pass through the start-up stage. He highlighted a section from (HBS professor emeritus) Tom McCraw's *Creating Modern Capitalism* book, wherein Henry Royce is talking about a decision whether to merge Rolls-Royce with Vickers, but "was determined to keep the firm independent." "From a personal point of view," Royce said, "I prefer to be absolute boss over my own department (even if it was extremely small) rather than to be associated with a much larger technical department over which I had only joint control." Royce could remain absolute boss over something extremely small, or could have something much larger over which he had to share control, and in this Rich versus King choice, he was choosing to remain King.

Q: Is it better to be focused on one or the other? Is it possible to have a healthy balance between the two and be both?

A: Most of the founders I have studied started off wanting to become both Rich and King—"Rich and Regal," if you will. This desire is reinforced when they see such prominent Rich and Regal entrepreneurs as Larry Ellison of Oracle Corporation, Marc Benioff of SalesForce.com, and Phil Knight of Nike. What's ignored is that these people are so well known precisely because they are the exceptions, the rare founders who are able to achieve both. Many others I've studied who tried to achieve both have ended up making some decisions consistent with Rich motivations and others consistent with King motivations, and in the process of mixing the two, ended up with neither.

A more successful approach seems to be that the entrepreneur step back to really understand what his or her true motivation is, Rich or King, and then to recurringly make decisions consistent with that motivation. This may reduce the chances of becoming Rich and Regal, but it may dramatically increase the chances of achieving what really motivated you to become an entrepreneur to begin with.

From an investor's perspective, Rich versus King is a fundamental issue.

At the same time, initial analyses of my dataset have helped me start understanding what separates the Rich and Regal entrepreneurs from those who have to choose between Rich versus King.

The strongest factors that emerged from those analyses were whether the entrepreneur had leveraged his or her own prior assets in building the venture—in particular, regarding financial assets, whether the entrepreneur had provided the seed capital for the venture, and regarding social networks, whether the entrepreneur had been able to tap investors who had previously invested in a company of the entrepreneur's. These entrepreneurs were much more likely to achieve Rich and Regal status than entrepreneurs who didn't provide their own seed capital and who took money from investors with whom they did not have a prior relationship. In my current analyses and case writing, I'm trying to explore further what separates these rare entrepreneurs from those who have to choose between Rich versus King.

Q: Is this perspective helpful to investors in these ventures? Should investors care whether a founder leans toward Rich or leans toward King?

A: From an investor's perspective, Rich versus King is a fundamental issue. During my internship in venture capital, I heard the phrase "Rich versus King" several times, and it even appears in a case we used to teach about Onset Ventures. In that context, it refers to what VCs look for in the entrepreneurs they might want to back. VCs invest in a company in order to maximize their financial returns from the company—i.e., to become Rich themselves. They are driven by the profit motive. If an entrepreneur wants to become Rich, then VCs see that entrepreneur's interests as being aligned with theirs, for they both want to maximize financial returns.

However, if an entrepreneur wants to become King, that entrepreneur is more driven by the control motive and is willing to sacrifice financial gains in order to keep control. The interests of such an entrepreneur are not aligned with those of the VCs, and in fact may be in direct conflict with them. Thus, from the beginning, many investors want to find out whether an entrepreneur is motivated by Rich or by King, and then only want to invest in the "I want to be Rich" subset. At the same time, savvy entrepreneurs know that this is what VCs are looking for, and are able to "talk the Rich talk" convincingly. For many VCs, seeing through to a founder's real motivations is critical, but can be very tough.

Q: Did anything in your findings surprise you?

A: Of the surprises I described above, the biggest was that there is, in fact, an inherent conflict between these two major motivations, making it hard for most entrepreneurs to achieve the Rich and Regal status that's motivating them to become entrepreneurs. An even bigger surprise will be if we can actually nail down a relatively complete picture of what separates the Rich and Regal entrepreneurs from the others!

Q: What are you working on now?

A: The first follow-up to this paper includes further efforts to nail down what separates Rich and Regal entrepreneurs from the others, to see if we can find overall best practices that might help guide entrepreneurs. This effort includes two parallel projects. The first entails more sophisticated and detailed quantitative analyses of my datasets. The second is a richer exploration of a smaller number of cases where founders were able to achieve Rich and Regal.

In my current case writing, I'm looking at a couple of entrepreneurs who have been able to keep control of the CEO position for much longer than we might expect, along with more creative ways that founders were able to achieve Rich and Regal status. For instance, a current case I'm developing examines whether franchising might be a good "almost King, almost Rich" option for both the potential franchisor and the potential first franchisee, one in which they give away a small portion of the profits and a small amount of control in order to increase dramatically their chances of ending up with high levels of both.

However, I'm always looking for new cases and new examples of founders who were able to achieve both. In particular, I would love to write a case on a serial founder who either made King-consistent choices in one venture and then made very different Rich-consistent choices in a subsequent venture, or who achieved Rich and Regal status only after falling susceptible to Rich versus King tradeoffs in prior ventures.

In addition, I'm currently working on projects that delve more deeply into both the determinants of entrepreneurs' financial gains and of whether they can keep control of their ventures. My initial paper in the financial gains realm was my entrepreneurial-compensation paper that was just published in the *Academy of Management Journal,* and current follow-up papers are "Splitting the Pie" (examining equity splits within the founding team) and "Golden Handcuffs" (examining the role of vesting terms). In the control realm, my 2003 paper in *Organization Science* on founder-CEO succession examined the factors that lead to a founder's being fired as CEO, but my recent case writing (the "Wily" case mentioned above) suggested that the founder's involvement in the search process and in the venture *after* being replaced may also have important post-succession implications for the venture. My "After the Firing" paper will delve into these implications.

Throughout all of this, I continue to post to my research blog both the early analyses and final results from these projects, and I love to get feedback there on the items I post. WK

About the author

Sarah Jane Gilbert is a project manager at Harvard Business School.