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Founders, Don't Let Your Ownership Split Get In The Way Of Being Innovative

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The team of founders is the driving force behind a startup. They manage the ongoing operations, push sales, and set the future direction of the startup. However, decision-making on how to move forward is challenging, and it becomes most difficult when future outcomes are uncertain.

In our current study, we are asking ourselves to what extent the "founder's agreement" – that is ownership split among founders – influences the decision-making of founding teams when there is little known about the future. Every founding team decides on its ownership split at incorporation. This is not only the first deal that founders close, but also a decision that imprints into the internal structure of the startup. More specifically, by splitting ownership equally or unequally, every founding team determines if they want to work together as equal or unequal partners.

We argue that this early decision about the internal structure influences how founding teams make decisions. In founding teams with equal ownership, split all founders have the same say and thus decide jointly. However, in their counterparts with an unequal ownership split, the ownership split determines who defers to whom when it comes to decision-making. Thus, the founder with the largest ownership share has a central role for the founding team's decision-making.

To study how the "founder's agreement" influences founding teams' decision-making, we focus on a decision that every tech-startup faces: Should we move into a new field and pursue new innovative initiatives? Technology is a "boom-or-bust business", with less than 10% of new innovative initiatives succeeding later on in the market (in some areas the rates are even lower, e.g., vaccines). Thus, founders do not know if their decision to start a new innovative initiative results in great success.

Not surprisingly, founders tell stories of endless discussions and difficult conversations, which make it hard or even impossible to find an agreement and make a decision to move forward. In such situations, the clear decision-making structure of founding teams with an unequal ownership split might be beneficial. As a central decision-maker, the founder with the largest ownership share can resolve long discussions within the founding team and facilitate decision-making. Thereby, resources can be directed quickly towards new innovative initiatives, and the process of constant testing, learning, and adjusting can start. Furthermore, due to his or her significant stake in the startup, the founder with the largest ownership share has a strong interest in long-term success and thus rather tends to start initiatives in favor of exploring new fields. In contrast, equal teams might get stuck in reaching a consensus or end up agreeing on a minimum viable compromise.

Therefore, we argue that founding teams with an unequal ownership split are more likely to move into new fields. Our reasoning is reflected in our preliminary results. Out of a sample of 2,148 startups, we find that those startups whose founding teams split ownership unequally are more likely to move into new fields.

Thereby, our study indicates that the decision on how to split ownership has implications for the startup's long-term outcomes, e.g., by facilitating the realization of specific innovation paths. While being so important for the future of the startup, the "founder's agreement" is frequently done quickly and without any deep reflections. For example, survey data has shown that about 40% of the founding teams make this decision within less than one day. Thus, in line with studies that looked at the factors that influence the ownership split among founders, our findings suggest that founding teams should thoroughly consider this decision.

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