JOURNAL OF SMALL BUSINESS STRATEGY

DISPROPORTIONATE DISTRIBUTION OF STOCK OWNERSHIP AMONG INITIAL FOUNDERS IN STARTUP VENTURES: SURVEY RESULTS AND A RANKING OF FACTORS

Joseph R. Bell
University of Arkansas at Little Rock
jrbell@ualr.edu

ABSTRACT

To date little research has been performed as to how founders of startup ventures determine initial distribution of ownership. In many instances, distribution of ownership is proportionally divided, even though individual contributions to the venture may vary widely. In these circumstances, a disproportionate distribution of ownership would be more reflective of individual contributions to the venture, and more importantly, determine the appropriate incentive (or "reward") for each founder. A survey of business owners was administered, and counter to much of the existing literature, a significant percentage of the respondents divided ownership disproportionately. The survey provides a ranking of factors that can contribute to disproportionate distribution of ownership.

Keywords: founders, division of ownership, ownership, equity, distribution, dilution

INTRODUCTION

Distribution of ownership is important for all businesses, for it ties to not only motivation of team members and their potential financial rewards, but also, in some instances, to control and decision-making for the venture. For the focus of this paper, distribution of ownership among the founders of a venture becomes important when the objective of the business is to significantly grow the business and create a harvest or exit event. For a business to grow, it often requires a founding team comprised of members with diverse and complementary skill sets necessary to move the business forward.

This paper is designed to stimulate discussion and research in determining which factors contribute to the disproportionate distribution of initial ownership. Past research has discussed disproportionate distribution of initial ownership but has not attempted to establish a ranked order of the factors. The paper sets forth a ranked order of factors based upon the results of a survey ("Business Ownership Survey" or "BOS"). This research begins a dialog to assist entrepreneurs with divergent skill sets and backgrounds to knowledgeably allocate stock ownership on a disproportionate, yet fair and appropriate basis.

Initially, the paper covers a review of the literature by explaining the role of team contribution to the venture and why disproportionate distribution is important. It then goes on to cover the different factors for the disproportionate distribution of ownership while proposing a ranked order for the various factors based upon the BOS results. The conclusion provides recommendations for future research.

LITERATURE REVIEW

The Importance of a Team

Cachon (1990) concluded that the lone entrepreneur is a mythological being, suggesting that most entrepreneurial organizations require entrepreneurial teams in order to function effectively, while Chowdhury (2005) suggests the battle of the "lonely hero" is giving way to a prevalence of entrepreneurial teams as an emerging economic reality. The entrepreneurial team has been defined as the group of people involved in the creation and management of a new venture (Forbes, et al, 2006: Cooper and Daily, 1997: Kamm, et al 1990). For an entrepreneurial venture to successfully raise external capital often depends upon whether or not it is headed by an effective venture management team (Vanaelst, et al, 2006). Additionally, research has shown that the management team is predominant in the venture capital evaluation process (Zopounidis, 1994).

As Forbes (2006) points out, organizational behavior research about teamwork has focused largely on behavior in existing work teams and in teams without hiring authority, ignoring team formation. Thus, there is little existing theory regarding entrepreneurial team formation.

Ensley, Carland and Carland (1998) require three criteria be met in defining the entrepreneurial team: they (1) have to jointly establish a firm, (2) have a financial interest, (3) have a direct influence on the strategic choice of the firm. Other researchers have made the equity stake condition stricter and have imposed a minimum contribution before one can be considered a member of an entrepreneurial team (Ucbasaran, et al 2003).

Disproportionate Distribution

Kamm, et al (1990) identified distribution of ownership as an important cost of assembling effective entrepreneurial teams. According to Neal (2004), the default position for too many entrepreneurial companies is to divide stock ownership on a proportional basis. This position was previously discussed by Timmons (1975) within the Commune Approach, whereby founders demonstrate their equality with such democratic trimmings as the equal stock ownership. While he noted that there are temptations by team members to treat each partner equally, however, this should be considered a serious red flag. Timmons (1975) implied that distribution of ownership is of serious importance because it affects both the founders internally and its interpretation by investors externally.

Timmons (1979) later stated that team members who have much in common in background and experience may faithfully adhere to their peer status when it comes to distribution of stock and salary levels, and therefore, they may insist that all of them receive the same amount. They unrealistically assume that equality is best and make little effort to address the complex implications for motivating and rewarding contributions to the budding company. The most successful ventures, in contrast, intuitively or by design, do not treat everyone equally (Timmons, 1979).

The objective of disproportionate distribution among initial founders is to appropriately recognize the contributions each team member will make to the venture, and to adequately motivate, or incent, their optimal performance. Some refer to this distribution as magic (Barry, 2007).

Timmons (1975) suggests that an outsider experienced in these matters can contribute significantly to an agreed disproportionate distribution of stock ownership among founders. Because each venture is unique, it is preferable for team members to reach a reasoned decision concerning sensitive issues [such as distribution of ownership], rather than trying to apply some predetermined model, but Timmons (1975) goes on to suggest that weighing the criteria to determine disproportional distribution of stock ownership can be facilitated by an outsider familiar with both proven approaches and the behavioral dynamics that will emerge and must be dealt with. Though Timmons (1975) dismisses a formula-based solution to disproportionate distribution, he does recognize that factors which contribute to disproportionate distribution have differing impacts ("weighing") on how much ownership should be allotted to each founder.

Franke et al. (2006) surveyed 51 venture capitalists ("VCs") and asked them to rank founding teams based upon seven different criteria. The criteria included factors such as prior experience, age, level of education, field of education, industry experience, etc. Their findings held that VCs rank the importance of the team characteristics as mirror images of their own characteristics. From this paper's standpoint, these findings do two things: first, the findings validate that criteria or "factors" can be important in securing external investment, and second, that VCs have preferences in regard to those factors. In other words, first, factors are important and second, as Timmons (1975) and Franke, et al (2006) point out, different factors can be regarded as having differing levels of importance to the success of the venture. This is also discussed later by Dimov and Shepherd (2005), Watson, et al (2003) and others.

Importance of Ownership: Internal

Some research has taken place identifying ranges of ownership by founder position within a venture. The 2005 Compensation and Entrepreneurship Report and Information Technology sponsored by Wilmer, Cutler, Pickering, Hale and Dorr, Ernst & Young, and J. Robert Scott (2007) and, the 2006 Compensation and Entrepreneurship Report and Information Technology sponsored by WilmerHale, Ernst & Young, and J. Robert Scott, (2007), represent the sixth and seventh annual compensation reports. Through their research, they establish a range of ownership for founding team members (e.g., CEO, CTO, etc.) during different stages of equity financing by financing round. They begin by premising that there is very little compensation data available on private companies (Compensation and Entrepreneurship Report and Information Technology, 2006). Their studies involved 260 private companies in 2005 and over 300 private companies across five industry segments in 2006. The studies were performed to provide an understanding of distribution by position and financing round to assist ventures in attracting, rewarding, and retaining key personnel.

For example, the studies found that prior to, or at the time of, the first round of funding, a founder CEO in the year 2005 study retained an equity position somewhere between 11.35% and 28.50%, and in the 2006 study between 10.45% and 50%. And again, for example, the foundering Chief Technology Officer (CTO) for the years 2005 and 2006 should range between .34% and 2.00%, and 4.00% and 15.00%, respectively. This survey data establishes equity ownership ranges by funding round and founder position within the venture. This paper proposes that the range associated within each founder position (e.g., CEO) is due, at least in some part, to perceived individual backgrounds or “factors” that can create the variances within the range and across positions held by all founders within the venture.

Distribution of ownership becomes very important since during a first round of external investor funding, the venture can expect to part with between 20% and 40% of the overall ownership in the venture, depending upon the pre- and post-money valuations (Headapohl, 2007). By the time the founding group is at IPO, the founders should expect to have parted with somewhere between 70% and 80% of their ownership in the venture (Robbins, 2005).

To the founders this means that as the companies mature their slices of the ownership pie get smaller. The expectation, and hope, is that the overall value of the pie has increased substantially and the remaining founder ownership interest is adequately large enough to continue to incent performance. Founders should therefore be hyper-sensitive to the initial ownership distribution since their ownership percentage at harvest may be significantly diluted.

Importance of Ownership: External
New venture teams can communicate value through signals to potential investors (Busenitz, Fiet and Moesel, 2005: Leland & Pyle, 1977). Lester, et al (2006) discussed signaling theories employed by the top management teams where investors look for clues which might lead to increasing the odds of picking a high-quality firm. By increasing firm organizational legitimacy through signaling, there is the belief that individuals ascribe different values, skills, and abilities to status characteristics such as education, contacts, and experiences. Some examples of those characteristics concluded that early-stage investors place a high value on educational prestige while previous board experience was not a critical factor. Also, investors are interested in general experience rather than experience confined to a specific industry or situation.

Prasad, Burton, and Vozikis (2000) add that an entrepreneur's shareholding level as a signal of value may not always provide an accurate perception because an entrepreneur's limited initial wealth and consequently low shareholding level could not adequately reflect the true value an entrepreneur expects from a project. But what Prasad, et al. (2000) go on to state is that a more reliable measure of the value of a new venture is the proportion of the initial wealth of the new venture team members vest in the venture. In other words, they suggest that there are significant founder contributions to a venture other than just capital. The ownership interest held by the each member of the new venture team can communicate the value each member represents to the overall venture.

Signaling means that it is not only important for the founders to understand the underlying factors that lead to disproportionate distribution of ownership, but it also can communicate a degree of competency to an external funding group. This would seem to support the earlier contention by Timmons (1975) that equal treatment of founders should be considered a serious red flag, and in our example here, a serious concern to external funders.

FACTOR DISCUSSION

As Neal (2004) and Timmons (1975) pointed out, in general, when founders come together to form a business venture, division of ownership will fall directly proportional to the number of individuals that form the venture. For example, if four founders establish a venture, each would share equally in ownership and result in a 25% ownership position for each founder (Neal, 2004). This suggests that a number of factors that should come into play to evaluate true contribution, and correspondingly division of ownership, are often ignored. More importantly, when external funding is sought, it "signals" prospective investors that the founding team has not addressed the issue of disproportional distribution. Is this reflective of other difficult decisions the team will face as the venture matures?

Researchers recognize that financial capital is only one of the necessary resources for startup firms (Chandler, 1998, Prasaad, Parton and Vozikis, 2000) and of all resources available to firms, human resources are perhaps of most importance (Chandler, 1992). The human capital provided by founders' abilities is an important contributor to the success of the firm (Cooper, Gimeno-Gascon and Woo, 1994).

Dimov and Shepherd (2005) found that human capital provides for significant variations in the overall firm performance. They suggest that a significant contribution to the literature may be provided by future research that focuses upon the differences in skill sets required to ensure success of venture. Watson et al. (2003), determined that work experience, education, and interpersonal functioning played a significant role in understanding the success of a venture. They then went on to state that human capital, in the form of education and work experience, positively influences firm performance and should be a part of the equation for evaluating venture potential. The combination of education and experience provides a skill set that is more relevant to the demands of planning for and executing growth. And they conclude that these considerations should be equally important to partners and venture capital institutions when making decisions concerning business initiation. Beckman et al. (2007) determined that entrepreneurial teams are complex combinations of experiences and affiliation and this can significantly affect firm outcomes. These factors become important in attracting the attention of venture capital firms in deciding whether or not to fund a new venture.

Timmons and Spinelli (2007) suggested that a good reward system reflects the goals of the venture and places it in a good position for valuation and raising external capital. They go on to suggest issues that should be considered in a quality reward system include differentiation of contribution, performance (outcomes) rather than effort, and flexibility, in that rules may change or even be eliminated. Considerations of value would include:

- The idea
- Business plan preparation
- Commitment and risk
- Skills, experience, track record, or contacts
- Responsibility

They suggest that early contributions, such as the originator of the idea or significant contributions to the business plan, have historically been overvalued. Robbins (2003) suggests the earlier, bigger, or longer the contribution to the company, the more equity a founder should receive. Other factors in considering disproportionate distribution of stock ownership include decision-making control over the business, early monetary contributions, and in-kind contributions. Robbins (2005) also suggested that there are several factors which need to be taken into consideration including timing, size, and duration of the individual contribution.

As pointed out earlier, Neal (2004) asserted that too many entrepreneurs go to the default position of proportional distribution of stock ownership. He goes on to list criteria to argue disproportional distribution of stock ownership including:

- How much time has each of the founders put into the company before the formation of the legal entity?
- How much sacrifice has each of the founders endured to make the company's formation a reality?
- Will each founder be joining the company on a fulltime basis when the entity is formed?
- What skills does each of the founders bring to the company?
- What are the relative values of the skills that the founders possess?
- How much capital, if any, has been contributed by each founder?

RESEARCH DESIGN

For the target population, going-concern companies receiving counseling services from the Arkansas Small Business and Technology Development Center were identified. This created a population of 2807 clients, based on March 2008 records. The author used a simple random sampling strategy. Companies that met the criteria of having started their operations at the beginning of 2006 or earlier and who were still in the business at the time of the survey were accepted as the sampled population for this study, which created an a priori sample population of 1476 clients.

The author then developed the Internet survey instrument and placed it on-line with assistance from the Arkansas Small Business and Technology Development Center (ASBTDC). Prior to the release of the survey, three email messages were written and sent to the selected survey population. The researcher provided ASBTDC with text of the email messages and the ASBTDC contacted persons via email regarding this study. The first email was sent a week before the survey was available to potential respondents. The second email was sent when the survey was available and requested that potential respondents complete the survey. The third email was sent the following week as a reminder that the survey was on-line and available for responses.

As required by Institutional Review Board guidelines, potential survey respondents were assured of confidentiality and anonymity. It was also noted that participation was strictly voluntary among those contacted. No incentives of any kind were offered by the researchers or ASBTDC for participation in the survey. The researchers are unaware of the identities of the respondents and to the researcher's knowledge, are not personally involved with any respondents of this study.

After collecting the data, the respondent pool was revisited. Cases of duplicate respondents from the same company were sorted and the primary respondent was retained. Between these duplicates and bounced e-mails, 173 of the potential client population (equal to 11.7% of the total clients sampled) were removed from the a priori sample population. A total of 162 survey responses were collected among the 1303 remaining valid e-mails, which equates to a 12.4% response rate.

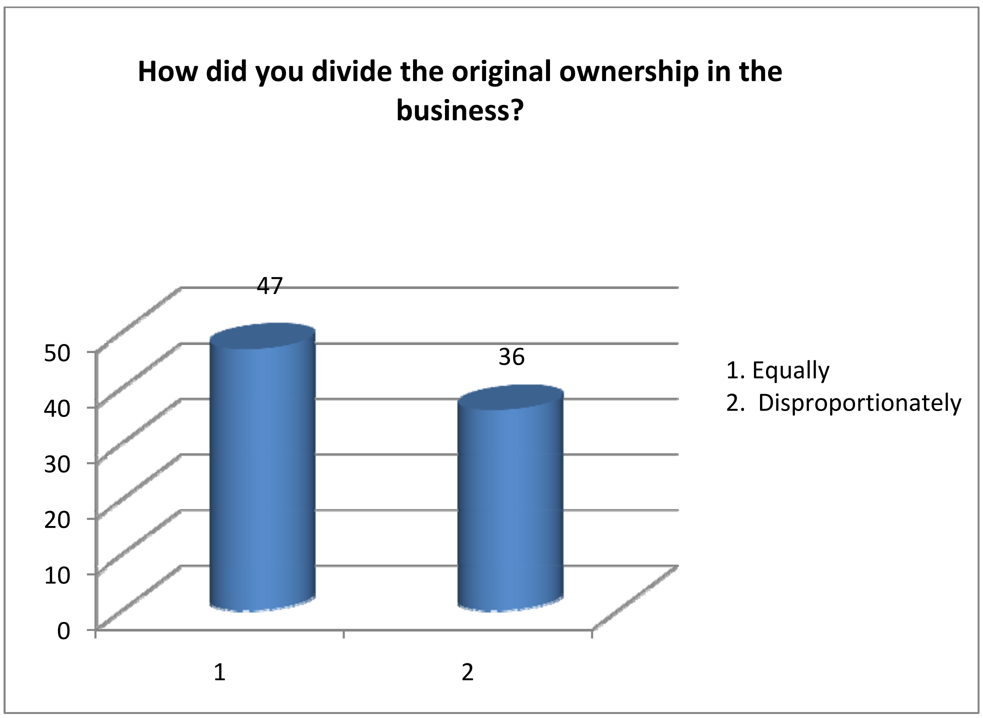
Survey respondents were asked to review and complete a 28-item survey instrument. The survey items of interest to this paper include items one through three which asked about founders' ownership of, and allocation of equity within, the firm. The remainder of the survey dealt with questions related to the owners' knowledge level concerning business financing as well as their financial contributions to the business startup, external funding for the firm, the company's current capital structure, owner attitudes toward funding options for the firm, both historical funding and potential future resources, and finally, use of business planning and whether they had used the plan for raising funds in the past. This paper focuses upon questions one through three of the survey (See Appendix 1).

The data was assessed to determine statistical significance of the responses to question 3 using ANOVA analysis. It is assumed that the data is normally distributed; homogeneous covariance and the samples are independent. The null hypothesis mean ranks of factors determining ownership are equivalent; alternative mean ranks are not equivalent. The null hypothesis is rejected at $p < .0001$ and $F = 6.02$. The findings are that the results of the survey were unlikely to occur by chance and the ANOVA analysis supports the ranked order conclusions discussed in the paper. (See also, Appendix 2)

BUSINESS OWNERSHIP SURVEY RESULTS

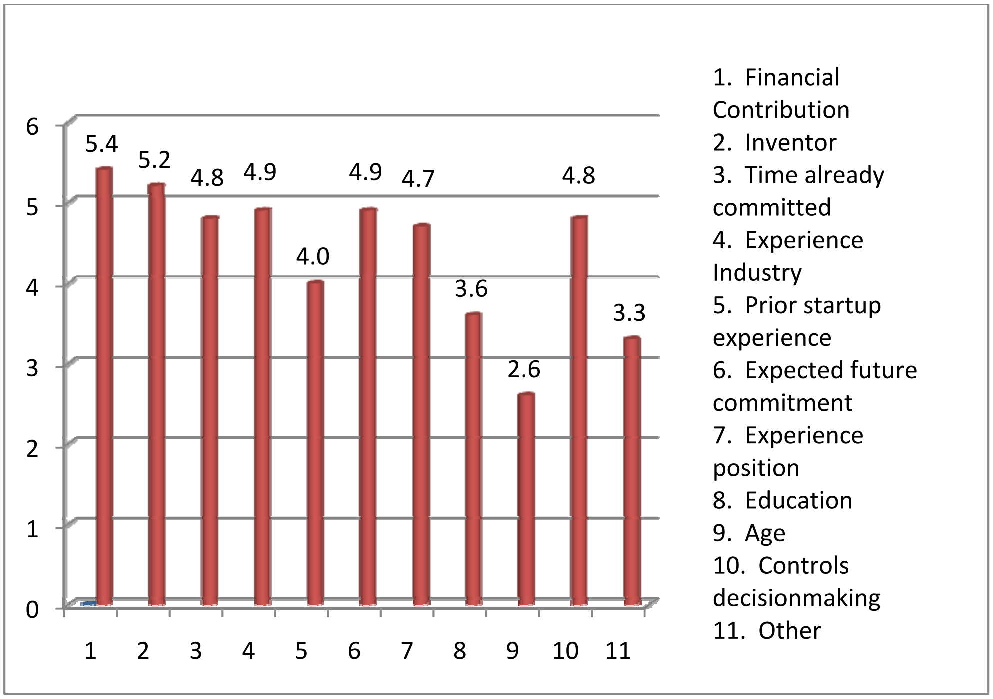
In stark contrast to the existing research, when single ownership is factored out of the response to Question 2 of the BOS ("Business Ownership Survey"), over 40% of the respondents (N=36) divided ownership disproportionately. All respondents completed question 2. Question 2 asked respondents if they divided ownership equally or disproportionately. In total, 126 responded to having distributed ownership equally while 36 responded that their distribution of ownership was disproportionate. Question 1 asked for the respondent to identify the number of founders in the firm. When the 79 single owner firms are factored out, 47 respondents indicated equal distribution of ownership.

FIGURE 1 – RESPONSES TO SURVEY QUESTION 2



The BOS results of Question 3 asked respondents to rank the following factors when considering disproportional distribution of stock ownership among initial founders. Figure 2 displays the results of survey Question 3 as an average from a 7-point Likert scale with 7 representing most important and 1 being least important.

FIGURE 2 – SURVEY RESULTS FROM QUESTION 3 – DISTRIBUTION CRITERIA



Financial contribution of the founders is the first ranked factor when assessing disproportionate stock distributions.

Monetary contributions represent a very critical component, not only when estimating distribution of initial ownership, but also for subsequent valuations when raising external capital. Stevenson, Roberts, and Grousbeck (1994) stated that investors perceive, and rightly so, that the individual entrepreneur will be more committed to the venture if she or he has a substantial portion of personal assets invested in the venture. Investors view monetary contributions to the business by founders very favorably and refer to it as the founder having skin in the game.

But with an early stage venture, in general, little money has been infused into the business by the founders while the vast majority of ownership value will come from more nebulous sources, as Chandler (1992) and Cooper, et al (1994) referred to as human capital.

The originator of the idea or inventor founder(s) is the second ranked factor when assessing disproportionate stock distributions.

Max Levchin, the founder of PayPal believes an idea represents 5% of the success of a company, whereas execution represents 95% (Cringely, 2005). Absent, additional, or ongoing contributions to the venture, this is not an uncommon allocation of ownership set aside solely for the inventor or idea generator.

There seems to be a significant disparity between the BOS results and the research, e.g., Cringely (2005) and Timmons (2007), in regard to the importance of the original idea or inventor as compared to the survey. Since in most instances the individual that responded to the BOS was the originator of the idea, there exists potential for strong personal bias in the responses. The future research suggested later in this paper addresses a number of issues regarding disproportionate distribution of initial ownership, but importantly, this particular result.

Expectation of future time committed to the venture (execution) by the founders and past experience in the industry are tied as the third ranked factors when assessing disproportionate stock distributions.

Timmons (2007) suggested that early contributions to the venture are overvalued and ownership needs to be tied to performance or execution. Those individuals who quit jobs to devote their full energies to the success of the venture are obviously of significant value versus individuals who are unwilling to commit time or only assist with the venture on a part time basis.

Kor (2003) suggested that apart from those individuals that are required for the development of the technology, experience in the industry is an important contribution an individual can make to an early stage venture. Kor (2003) also asserted that industry specific management experience contributed to the competence of the management team and is useful in creating entrepreneurial growth. Roberts and Berry (1985) found that familiarity with the technology and the market being addressed is the critical variable that explains much of the success or failure in new business development. Ronstadt (1984) furthers the criteria by noting that managerial experience without product and market experience can be illusory. And Beckman et al. (2007) stated that having broad functional industry experience signals that the management team has the requisite skills and capabilities and provides access to venture capital investment.

Or, a bit to the contrary, as Lester et al. (2006) stated earlier, general experience is more important than industry-specific experience, and Cliff et al. (2006) found that experienced entrepreneurs were more “imitative”, while those with less experience were more innovative. This obviously lends credence to the fact that there are differing viewpoints as to how important certain factors are and where they might be ranked.

Past time committed to the venture by the founders, and who controls the decision-making, are tied for the fifth ranked factors when assessing disproportionate stock distributions.

What historical contributions do for ownership is to create overall value in the company. In other words, as the value of the company, prior to an external investment, increases, the proportion of ownership that is retained by the founders is greater. Therefore, time committed to the venture to date directly affects the ownership interests of the entire founding team. But, from the investor perspective, the valued contribution is not so much positioning the company for funding but executing the plan to the point of an exit or harvest event (Timmons, 2007).

Robbins (2003) suggests that those who make the decisions for the venture should be entitled to additional ownership.

Past experience in the position by the founders is the seventh ranked factor when assessing disproportionate stock distributions.

Significant value would be placed upon the individual bringing vast experience to the venture (Wasserman, 2003; Amason et al. 2006). It is also contended that entrepreneurs are generalists and benefit from a diversity of previous experience (Rubenson and Gupta, 1996). Beckman et al. (2007) found that prior management experience helped the firm obtain venture capital and ultimately go public. Participation by the founder in top management is more important to the economic success of the firm than industry-specific management experience. When participation and industry specific experience are bundled, it creates a significant competitive advantage (Kor, 2003).

Not only is industry experience important, specific skills of the new venture team are also important in the development of the new venture (Roure and Keeley, 1990).

Prior entrepreneurial endeavors by the founders is the eighth ranked factor when assessing disproportionate stock distributions.

Wright, Westhead and Sohl, (1998) suggest that prior business ownership creates assets which may include, managerial and technical skills required for subsequent venture success, including marketing and financial expertise, as well as the ability to identify and serve market segments that have both growth potential and profit possibilities. Experience may bring a range of contacts that can be built upon in subsequent ventures. They go on to state that experienced entrepreneurs owning a new business in the same sector as their previous or current venture are likely to be in a relatively stronger position by virtue of that experience than novice founders. Birley and Westhead (1993) defined a "habitual" founder as having established at least one other business prior to starting a new independent venture. Case study evidence shows that habitual entrepreneurs perceive clear benefits in negotiating further details because of their prior entrepreneurial experience (Wright et al. 1997).

Ennico (2002) states that investors want now, more than ever, to invest in people, and they want to invest in people with a track record. Rubenson and Gupta (1996) conclude that prior entrepreneurial experience is one of the best predictors of entrepreneurial success. Interestingly, Beckman et al. (2007) found that prior startup experience decreases the rate of obtaining venture capital, but increases the rate of initial public offerings.

Having served in a leadership position in prior entrepreneurial ventures creates an undeniable track record. This factor alone can drive the investment decision.

Once again, the BOS results skew quite negatively toward the importance of prior business startups, ranking it eighth out of 11 topics (See Table 2).

There exist additional factors which may influence the disproportionate distribution of stock.

The following factors may also play a role in a disproportionate distribution of ownership among initial founders. In deference to the length of the BOS that respondents were asked to complete, not all of the following factors were requested as a part of the survey instrument. Each factor is identified with a brief explanation as to their impact:

- Highest level of education as related to the position (Coleman, S., 2007, Amason , et al, 2006) – Should someone with a Ph.D. receive a higher proportion of ownership interest than someone who does not possess that level of educational attainment? What if the education is not company or industry specific? Dimov and Shepherd (2005) found a strong positive relationship between education as a proxy for general human capital and firm performance. They found that teams with higher specific human capital – MBA, law education and consulting experience – have lower proportions of bankruptcies. Or again as Lester et al. (2006) pointed out earlier, would education play a different role if your degree was from a notable institution, or for that matter, the same institution as the VC principal? The respondents of the BOS ranked level of education as the ninth most important factor (See Table 2).

- Age (Amason et al. 2006; Levesque and Minniti, 2006; Chowdhury, 2005) – When the founders of a venture are relatively young it has been said that the presence of a "gray hair" can significantly increase their credibility. Should someone's experiences or wisdom count toward a disproportionate amount of ownership interest? Or, as pointed out by Rubenson and Gupta (1996), consistent [research] results are that youth is associated with growth, innovation, and risk taking, while older general managers are more conservative. As mentioned earlier by Wasserman (2003), significant value is placed upon individuals that bring vast experience to the venture. The respondents to the BOS ranked age as the least important factor in regard to disproportionate distribution of initial ownership (See Table 2).

- Total number of founders (Chandler, 2005) – Are certain members of the founding team disincented because the ownership interest is spread across a large number of founders? Should the percentage of ownership received by one founder affect the percentage of ownership received by other founders?

- Expected growth in revenue/returns – Should the ultimate size or valuation of the company play a role in disproportional ownership interests?

- Dilution – When subsequent rounds of funding are raised, existing ownership interests are diluted or reduced. Should disproportional ownership interests be considered in light of possible future dilution and possible loss of control, decision-making, or outright ouster of part or all of the management team? (Wu et al. 2007; Wasserman, 2003)

- Industry – Do different industries lend themselves to differing distributions, for example technology or bioscience?

- Team Diversity – What affects, if any, does team diversity have on distribution of ownership? (Chaganti et al. 2008; Beckman et al. 2007; Becker-Blease and Sohl, 2007; Chowdhury, 2005)

CONCLUSION

This paper attempts to create a ranked order for the importance of factors that can support the disproportionate distribution of ownership among initial founders. A number of previous discussions initiated by Timmons (2007), Robbins (2005), Neal (2004), and others have taken place illuminating some of the factors that might contribute to disproportionate distributions, but none have attempted to suggest which factors are more valuable to the success of the venture. This paper establishes factors in ranked order and goes on to identify additional factors, though secondary, that may influence the disproportionate distribution of ownership. The discussion of these factors is supported by the aforementioned researchers and is of importance to both the entrepreneur and investor when the outcome of ownership is incenting performance and execution of the business model.

The BOS survey seemed to identify a number of the factors ranked close to what the qualitative research seemed to suggest. For example, future time committed to the venture and past experience in the industry were rated as a very important contributing factors to determination of distribution (4.9 on a scale of 7) while cash contributions to the venture ranked first (5.4). These rankings seem very much in line with the existing research commentary.

Factors identified within the survey results that seem to be valued of greater importance by the respondents than that identified in the prevailing literature include past time committed to the venture (4.8) and the originator of the idea or inventor (5.2). A factor identified within the survey results that seem to be valued of less importance by the respondents than that identified in the prevailing literature includes prior entrepreneurial experience (4.0). This result was well down on the scale and is somewhat troubling since the emphasis in the literature, and within the investment community at large, seems to place prior entrepreneurial experience as being of significant importance.

Overall, the BOS may have demonstrated that more entrepreneurs are disproportionately distributing initial ownership among founders, but they may not always be doing so based upon the correct factors. This leads to a discussion of the limitations of the BOS and future opportunities to expand upon the research.

LIMITATIONS OF THE RESAERCH AND FUTURE RESEARCH IMPLICATIONS

To date, no other research has attempted to place in ranked order of importance factors that may affect disproportionate distribution of stock ownership among initial founders. The selected rankings are chosen based upon BOS results. The paper suggests that additional primary research needs to be performed to give credibility to the ordering and possible weighting of the factors. Existing research seems to support disproportional ownership among initial founders and has concluded that most founders distributed ownership on a proportional basis. But the BOS results seem to counter the thought that most founders distribute disproportionately, with over 40% of the BOS respondents indicating they distributed ownership disproportionately. The news on that front is good. A concern seems to enter the picture when the factors are ranked in comparison to the existing qualitative research perspective where some of the survey results seem to be out of sync with the research. For example, Timmons et al. (2007) and others put a very high emphasis upon past entrepreneurial experience, yet the survey group ranked it as eighth in importance. Again, the inventor or original idea person was ranked second in importance whereas Timmons et al. (2007) suggests that the vast majority of value is in the execution, and Cringely (2005), in quoting Max Levchin, the founder of PayPal, stated that the idea represents 5% of the success of a company whereas execution represents 95%.

The survey also neglected to ask why the distributions were disproportionate. This could skew the results. For example, if someone made a small cash contribution to the venture and received only a small ownership interest based solely upon that cash contribution, what they would receive would be disproportionate, but only because they were considered a "cash-only" founder and not a part of the ongoing management team.

Entrepreneurs in general, or for that matter anyone, when surveyed and asked to rank factors that they may, and/or may not possess, will act much like the VCs discussed earlier. There Franke et al. (2006) observed the VC response tended to reflect what they look like ("mirror images") rather than a more neutral or unbiased opinion.

Future efforts can look to two other groups of respondents. The first is to identify serial or habitual entrepreneurs, those who have repeatedly gone through the process of business formation, raising capital, and creating a harvest event, and who may utilize disproportional allocation of founder ownership interests based upon certain factors. This group of entrepreneurs is far more finite and more difficult to identify and survey than the respondents in the BOS.

Second, the author believes it may be more appropriate, rather than targeting entrepreneurs, that there may be a greater appreciation for a disproportional distribution of founder ownership interests from the perspective of the investor. Because investors are driven by return on their investment, they may have strong feelings about an appropriate disproportional incentive across not only the founders, but the entire management team. Savvy investors are well aware of incenting to motivate performance to achieve desired results. The caveat seems to be the results Franke et al. (2006) encountered with the "mirror image" results when the VCs were surveyed.

This paper attempts to set a baseline for factors which contribute to disproportional ownership interests among initial founders. Additional primary research could sustain assertions made herein or create new viewpoints regarding disproportional ownership interests. The results and assessment from this research could demonstrate the following:

- Garner a greater understanding of the value/ranking investors place upon differential factors
- Identify new or additional differentiating factors
- Create a weighted average of the identified factors

The research will specifically benefit the following:

- Founders – will now have a series of guidelines and/or formulas for disproportional distribution of ownership among founders, creating better matched rewards or incentives for contribution, and making the venture more attractive for external funding
- Funders – will have a common gauge for evaluating distribution of ownership among founders
- Educators – will have created a body of knowledge regarding the importance of identifiable factors surrounding disproportional distribution of founder ownership.

REFERENCES

2005 Compensation and Entrepreneurship Report in Information Technology, sponsored by Wilmer, Cutler, Pickering, Hale and Dorr, Ernst & Young, and J. Robert Scott, www.compstudy.com/libraryArchives/2005CompstudyIT(Full).pdf, , pp. 1-68, visited July 26, 2007.

2006 Compensation and Entrepreneurship Report in Information Technology, sponsored by WilmerHale, Ernst & Young, and J. Robert Scott, www.compstudy.com/libraryArchives/2006CompstudyIT(Abridged).pdf, pp. 1-24, visited July 26, 2007.

Amason, A.C., Shrader, R.C., and Tompson, G.H. (2006). Newness and novelty: relating top management team competition two new venture performance. <u>Journal of Business Venturing</u>, 21, 125-148.

Barry, Tim, www.bplans.com/qa/article.cfm/381?match=all&sf=equity, Negotiating Startup Equity, visited July 17, 2007.

Becker-Blease, J. R. and Sohl, J. E., 2007, Do Women-Owned Businesses Have Equal Access to Angel Capital?, Journal of Business Venturing, 22, pp.503-521.

Beckman, C. M., Burton, M. D. and O'Reilly, C., 2007, Early Teams: The Impact of Team Demography on VC Financing and Going Public, Journal of Business Venturing, 22, pp. 147-173.

Birley, S., and Westhead, P., 1990, Private Business Sales Environments In The United Kingdom, Journal of Business In Venturing, 5(6), pp349-373.

Busenitz, L.W., Fiet, J.O. and Moesel, D.D., 2005, Signaling In A Venture Capitalist - New Venture Team Funding Decisions: Long-Term Venture Outcomes?, Entrepreneurship Theory And Practice, 29 (1), January, pp 1-12.

Cachon, J-C., "A longitudinal investigation of entrepreneurial teams, Part One: Who is involved in what makes them succeed." 1990, In N.C. Churchill, W.D. Bygrave, J.A. Hornaday,

D.F. Muzyka, K. H. Vesper & W.E. Wetzel, Jr, Frontiers of Entrepreneurship Research. Wellesley, MA: Center for Entrepreneurial Studies, Babson College, 100 – 102.

Chaganti, R. S., Watts, A. D., Chaganti, R., and Zimmerman-Treichel, M., 2008, Ethnic- Immigrants in Founding Teams: Effects of Prospector Strategy and Performance in New Internet Ventures, Journal of Business Venturing, 23, pp. 113-139.

Chandler, G.N., and Hanks, S.W., An Examination Of The Suitability Of Founders Human And Financial Capital In Emerging Ventures, 1998, Journal Of Business Venturing, 13, pp 353-369.

Chandler, G.N., Founders Self-Assessed Competence and Venture Performance, 1992, Journal of Business Venturing, 7 (3), pp 223-236.

Chandler, G. N., Honig, B., and Wiklund, J., 2005, Antecedents, Moderators, and Performance Consequences of Membership Change In New Venture Teams, Journal of Business Venturing, 20, pp. 705-725.

Chowdhury, S., 2005, Demographic Diversity For Building An Effective Entrepreneurial Team; Is It Important?, Journal of Business Venturing, 20, pp. 727-746.

Cliff, J. E., Jennings, P. D., and Greenwood, R., 2006, New to the Game in Questioning the Rules: The Experiences and Beliefs Of Founders Store Imitative Versus Innovative Firms, Journal of Business Venturing, 21, 633-663.

Coleman, S., 2007, The Role Of Human and Financial Capital in the Profitability and Growth of Women-Owned Small Firms, Journal of Small Business Management, 45 (3), pp. 303-319.

Cooper, A. C.., and Daily, C.. M. (1997) Entrepreneurial Teams, Entrepreneurship 2000. Chicago: Upstart Publishing.

Cooper, A.C., Gimeno-Gascon, F.J., and Woo, C.Y., 1994, Initial Human and Financial Capital As Predictors Of New Venture Performance, Journal Of Business Venturing, 9(5), pp 371-396.

Cringely, Robert, 2005, Interview of Max Levchin, http://www.pbs.org/cringely/nerdtv/shows/, September 13.

Dimov, D.P. and Shepherd, D.A., 2005, Human Capital Theory and Venture Capital Firms: Exploring "Home Runs" and "Strikeouts", Journal of Business Venturing, 20, pp. 1-21.

Ennico, C, 2002, Commentary: What do investors really want? Long Island Business News, May 31.

Ensley, M.D., Carland, J.C. and Carland, J.W., 1998, The Effects Of Entrepreneurial Team Skill Heterogeneity And Functional Diversity On New Venture Performance. Journal of Business and Entrepreneurship, 10(1), pp 276-286.

Forbes, D. P., Borchert, P.S., Zellmer-Bruhn, M.E. and Sapienza, H.J., 2006, Entrepreneurial Team Formation: An Exploration of New Member Addition, Entrepreneurship Theory and Practice, 30 (2), March, pp 225-248.

Franke, N., Gruber, M., Harhoff, D., and Henkel, J., 2006, What you are is what you like – similarity biases in venture capitals' evaluations of start-up teams, Journal of Business Venturing, 21, pp 802-826.

Headapohl, J. (2007). *How much Stake do you feed an angel (investor)?*. Retrieved from http://www.startupnation.com/articles/1546/1/angel-investors-stake.asp, StartupNation, LLC, 2007, interview of Bill Payne who founded the Vegas Valley Angels in Nevada and now is an entrepreneur-in-residence at the Kauffman Foundation, visited July 26, 2007.

Kamm, J.B., Shuman, J.C., Seeger, J.A., and Nurick, A.J., 1990, Entrepreneurial Teams in New Venture Creation: A Research Agenda, Entrepreneurship Theory and Practice, 14(4) Summer pp 7-17.

Kor, Y.Y., Experience Based Top Management Team Competence and Sustained Growth, 2003, Organization Science, 14 (6), Nov.-Dec., pp 707-719.

Leland, H.E. and Pyle, D.H., 1977, Informational Asymmetries, Financial Structure, and Financial Intermediation, Journal of Finance, 32, pp 371-387.

Lester, R.H., Certo, S.T., Dalton, C.M., Dalton, D.R., and Cannella, Jr., A.A., 2006, Initial Public Offerings Investor Valuations: An Examination of Top Management Team Prestige And Environmental Uncertainty, Journal Of Small Business Management, 44 (1), pp 1-26.

Levesque, M., and Minniti, M., 2006, The Effect of Aging on Entrepreneurial Behavior, Journal of Business Venturing, 21, pp. 177 – 194.

Morino Institute, People Define the Deals, Venture Capitalists Share the Formula for Funding Success 1998, http://www.netpreneur.org/events/doughnets/article072898.html,. Falls Church, VA -- July 28, 1998, Visited June 13, 2007.

Neal D.A., 2004, Capital Structure for Entrepreneurs, Excerpted from FastTrac® Tech Ventures™. www.eventuring.org/.../appmanager/eVenturing/ShowDoc /eShipWebCacheRepository/Documents /Capital_Structure.pdf, visited July 17, 2007.

Prasad, Dev, Burton, G.D. and Vozikis, G., 2000, Signaling Value To Business Angels: The Proportion of Entrepreneurs Net Worth Invested In a New Venture as a Decision and Signal, Venture Capital, 23, pp. 167 – 182.

Robbins, S., 2003, Dividing Equity Between Founders and Investors, www.entrepreneur.com/ money/financing /venturecapital/article65028.html, October 13. Visited July 16, 2007.

Robbins, S. (2005). *Equity distribution in startups*. Retrieved from www.venturechoice.com/articles/ equity_distribution_in_startups.htm , visited July 16, 2007.

Roberts, E.B. and Berry, C.A., 1985, Entering a New Businesses: Selecting Strategies for Success, Sloan Management Review, 26(3), pp. 3-17.

Ronstadt, R.C., 1984, Entrepreneurship: text, cases and notes. Massachusetts: Lord Publishing.

Roure, J.B., and Keeley, R.H., 1990, Predictors of Success in New Technology Based Ventures, Journal of Business Venturing, 5, pp 201-220.

Rubenson, G.C. and Gupta, A.K., 1996, The Initial Succession: A Contingency Model Of Founder Tenure, Entrepreneurship Theory And Practice, 21(2), Winter, pp. 21-35.

Stevenson, H.H., Roberts, M.J., and Grousbeck, H.I., 1994, New Business Ventures and The Entrepreneur, Burr Ridge, IL: Richard D. Irwin.

Timmons, J.A., 1979, Growing Concerns: Tools for evaluating the startup venture in for financing the existing one, edited by David E. Gumpert, Harvard Business Review, Nov.-Dec., pp. 198-206.

Timmons, J.A., 1975, The Entrepreneurial Team: An American Dream or Nightmare, Journal of Small Business Management, 13(4), October, pp. 33-38.

Timmons, J.A., and Spinelli, S., 2007, New Venture Creation: Entrepreneurship for the 21st Century, McGraw-Hill Irwin.

Ucbasaran, D., Lockett, A, Wright, M., and Westhead, P., 2003, Entrepreneurial Founder Teams: Factors Associated with Members Entry and Exit. Entrepreneurship Theory and Practice, 28(2), pp107-127.

Vanaelst, I., Clarysse, B., Wright, M., Lockett, A., Moray, N., and S'Jegers, R., 2006, Entrepreneurial Team Development in Academic Spin Outs: An Examination of Team Heterogeneity, Entrepreneurship Theory and Practice, 30 (2), March, pp 249-271.

Wasserman, N., 2003, Founder-CEO Succession and the Paradox of Entrepreneurial Success, Organization Science, 14(2) Mar.-Ap., pp 149-172.

Watson, W., Stewart, W. and BerNir, A., 2003, The effects of human capital, organizational demography, and interpersonal processes on venture partner perceptions of firm profit and growth, Journal Of Business Venturing, 18, pp. 145-164.

Wright, M., Westhead, P., and Sohl, J., 1998, Editors' Introduction: Habitual Entrepreneurs and Angel Investors, Entrepreneurship Theory and Practice, 22 (4), Summer, pp. 5-21.

Wright, M., Robbie, K., and Ennew, C., 1997, Serial Entrepreneurs, British Journal of Management, 8(3), pp 251-268.

Wu, Z., Hedges, P. L., and Zhang, S., 2007, Effects of Concentrated Ownership and Owner Management on Small Business Debt Financing, Journal of Small Business Management, 45 (4), pp. 442-437.

Zopounidis, C., 1994. Venture Capital Modeling: Evaluation Criteria for the Appraisal of Investments. The Financier ACMT, 1(54-64), (May).

APPENDIX 1 – SURVEY QUESTIONS

1. How many founders including yourself started your business?

2. How did you divide the original ownership of the business?
   - Equally among all founders
   - Disproportionately

3. How important are the following factors in determining how to allocate ownership of the business disproportionately? Please rank the importance of each factor on a scale of 1 to 7, with 7 most important.
   - Financial contribution
   - Inventor or original idea person
   - Time already committed to the venture
   - Experience in the industry
   - Prior business startup experience
   - Expectation of future time committed to the business
   - Experience in the position
   - Level of education
   - Age
   - Whoever controls the decisions of the business
   - Other

APPENDIX 2 – LEVEL of RESPONSE

Question 3	N	Mean	Std Dev
a	28	5.500000000	2.02758751
b	29	4.724413793	2.15013700
c	29	4.37931034	2.19437256
d	29	4.62068966	2.07732302
e	29	3.51724138	2.02287345
f	29	4.55172414	2.16442349
g	29	4.24137931	2.08146879
h	29	3.48275862	1.63926573
i	29	2.17241379	1.25552964
j	29	4.96551724	2.16271586
k	11	3.09090909	2.25630430

Joseph R. Bell is an Associate Professor of Entrepreneurship at the University of Arkansas at Little Rock. He is also the Associate Director for Business Development at BioVentures, the commercialization and technology transfer arm of the University of Arkansas for Medical Sciences. His research focuses upon timely and practical issues affecting entrepreneurship and covers early-stage fundraising, entrepreneurship course work, and case writing. His research appears in such publications as Entrepreneurship Theory and Practice, the Entrepreneurial Executive, and the New England Journal of Entrepreneurship. He has also written a book entitled, "*Finding an Angel Investor in a Day: Get It Done Right, Get It Done Fast*". In addition, he has played a key role in numerous technology and bioscience startup ventures while serving at the "C" level in four ventures.