Handling succession of first-time founder CEOs

Are you the first-time founder of a successful startup company? Are you an employee, investor or director in a successful startup still led by a first-time founder as CEO?

Is there concern that the skills needed for successful launch may not suffice to reach the next level of growth?

GUEST COLUMN


Robert A. Adelson

In early-stage companies, a founder's success often speeds his or her replacement by a professional CEO to lead the next phase of growth of consolidation of existing growth.

The company's success in meeting its first milestone plus its need for new capital to feed growth – to capitalize on opportunities presented – often speeds a change at the top. Venture capital investors often condition funding on commitment to hire a professional CEO to lead the next phase of growth.

In mature companies, achieving revenue, profitability and market share assures the CEO's income and viability. Paradoxically, the reverse is often true for startup founder CEOs.

The founder CEO's passion, vision and willingness to take risks, essential to the startup's launch, are felt no longer needed to take the venture to the next stage. VCs now look to a proven ability to sustain infrastructure and organizational growth, to communicate, interface, harmonize and energize investors, directors, the media and other parties.

First-time founder CEOs may feel they can sustain growth, but investors in A and B rounds often require experience, a track record in scaling ventures to liquidity, before they will invest millions of dollars to fuel the next stage of growth.

The first-time founder seeking capital needs to recognize CEO succession is likely, perhaps inevitable, and take actions that benefit founder and company whether or not such succession occurs.

The first-time founder should build a strong board that includes independent, technology-savvy directors. Even as investment comes and investors' preferred stock terms exert a level of control, investors should not overload the board. It's best to have an independent majority of industry representatives who can also empathize with the founder-CEO with a minority of VC members of the board who can offer input but not control the direction of the firm.

In taking investment, it's wise to choose character over cash. Instead of focusing on valuation, spend time evaluating past investments in the field, experience and judgment. Even if the investors want a professional CEO, what input will the founder have? What will be the composition of the board? Founders should read the signs to be assured of mutual respect.

The first-time founder CEO also needs to protect himself – to assure legal and contractual protections for his post-CEO business position with regard to the company he directed.

When to seek protections? As soon in this process as possible. When the Series A or Series B investors condition funding on hiring a successor CEO, the founder CEO then needs to set terms for his own protection.

Succession is a two-way street. The founder shows himself a "team player," sharing with the investors the goal of making money. It's about success not power. Yet, just as the founder shows his willingness to yield power to everyone's financial gain, that's the time for the founder to achieve protection for his own stake in that financial gain.

For both founders and the company, careful planning including appropriate legal counsel improves the chances of the founder's consent to succession and successful transition of the successor CEO.

Additionally, for the founder who built the company, it's important to have your own counsel skilled in these matters. Having your own counsel focused on your interests and engaged early in the process improves your chances of avoiding the King Lear situation where all you built is owned by others and you, left with little recourse, to guide the enterprise or protect the investment of money, sweat and years of your life that went into creating the company that was once your baby.

Carry protection

Basic protections to seek with succession include these:

- Minority shareholder protections including for information, against dilution and for cash-out rights;
- Exercise rights over options, vesting of shares;
- Board representation or observer rights;
- Role in successor selection and transition;
- Post-employment paid consulting;
- Back licenses of technology, office support;
- Severance pay, post-termination benefits and coverages;
- Negotiation of noncompete, nonsolicitation, other restrictions.

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The article on the left -
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- If you have any questions or comments on this article

- If you are first-time founder CEO and would like help in the structuring and arrangements of your succession

- If you have questions regarding venture capital financing terms or your own stock or employment rights in the company

- Or if you have other questions or issues involving business, tax or employment law

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