

THE NEW VENTURE TEAM

In the world today, there's plenty of technology, plenty of entrepreneurs, plenty of venture capital. What's in short supply is great teams. Your biggest challenge will be building a great team.

John Doerr,
Partner, Kleiner, Perkins, Caufield & Byers

RESULTS EXPECTED

Upon completion of this chapter, you will be able to:

1. Articulate the role and significance of teams in building successful new ventures.
2. Recognize successful entrepreneurial philosophies and attitudes that can anchor vision in forming and developing effective new venture teams.
3. Identify the critical issues and hurdles, including common pitfalls, faced by entrepreneurs in forming and building new venture teams.
4. Understand issues of reward that new teams face in slicing the equity pie.
5. Develop a reward system for your own venture.

RESULTS EXPECTED

THE IMPORTANCE OF THE TEAM

The Connection to Success

Evidence suggests that a management team can make all the difference in venture success. There is a strong connection between the growth potential of a new venture (and its ability to attract capital beyond the founder's resources from private and venture capital backers) and the quality of its management team.

The existence of a quality management team is one of the major differences between a firm that provides its founder simply a job substitute, and the ability to employ perhaps a few family members and others, and a higher potential venture. The lone-wolf entrepreneur may make a living, but the team builder creates an organization and a company—a company where substantial value and harvest options are created.

Ventures that do not have teams are not necessarily predestined for the new venture graveyard. Yet, building a higher potential venture without a team is extremely difficult. Some entrepreneurs have acquired a distaste for partners, and some lead entrepreneurs

can be happy only if they are in complete control; that is, they want employees, not partners, either internally or as outside investors. Take, for instance, an entrepreneur who founded a high-technology firm that grew steadily, but slowly, over 10 years to nearly \$2 million in sales. As new patterns and technological advances in fibre optics drew much interest from venture capitalists, he had more than one offer of up to \$5 million of funding, which he turned down because the investors wanted to own 51 percent or more of his venture. Plainly and simply, he said, "I do not want to give up control of what I have worked so long and hard to create." While clearly the exception to the rule, this entrepreneur has managed to grow his business to more than \$20 million in sales.

Mahshad Koohgoli, is the founder of Spacebridge Networks, Lantern Communications Canada, and Protecode. On the subject of his start-up Nimcat Networks, he revealed that when the money ran out he called his team together to deliver a difficult message. Koohgoli: "I have enough money to keep the heating on and the lights on; if you leave, I understand. But I'm not going to leave, and I suggest you don't either." Nobody left. Koohgoli explained: "There's no way I can get anything done unless these people succeed so my job is to take away any impediments that might be in their way to success. If they fail it's because I haven't taken care of them." Stephen Daze, executive director of the Entrepreneurship Centre (www.entrepreneurship.com) added, "Koohgoli's faith in his team at Nimcat and their reciprocal faith in him turned out to be well-placed. One month after that tough meeting, the first round of financing came through and within 18 months Nimcat was sold for \$50 million, representing over eight times return on investment."¹

For decades, studies have pointed to the importance of a team approach to new venture creation. Solid teams are far more likely to attract venture capital, team-led start-ups have a greater chance of survival, and those enterprises often realize higher overall returns than ventures run by solo entrepreneurs.

Not only is the existence of a team important, but so too is the quality of that team. Because of this, venture capital investors are often very active in helping to shape—and reshape—management teams. One study demonstrated the increasing importance of team formation, teamwork history, and cooperation between new venture teams and venture capitalists.² This is especially true today with highly technical ventures in areas such as biotechnology, nanotechnology, and photonics. Elicia Maine of Simon Fraser University and Elizabeth Garnsey of the University of Cambridge observe "smaller and newer firms are playing an increasing role in the advanced materials sector."³

There is, then, a valuable role that the right partner(s) can play in a venture. In addition, mounting evidence suggests that entrepreneurs face loneliness, stress, and other pressures. At the very least, finding the right partner can mitigate these pressures.⁴ The key is identifying and working with the right partner or partners. Getting the right partners and working with them successfully usually involves anticipating and dealing with some very critical issues and hurdles, when it is neither too early nor too late.

FORMING AND BUILDING TEAMS

Anchoring Vision in Team Philosophy and Attitudes

The most successful entrepreneurs seem to anchor their vision of the future in certain entrepreneurial philosophies and attitudes (i.e., attitudes about what a team is, what its mission is, and how it will be rewarded). The soul of this vision concerns what the founder or founders are trying to accomplish and the unwritten ground rules that become the fabric, character, and purpose guiding how a team will work together, succeed and make mistakes together, and realize a harvest together. The rewards, compensation, and incentive structures rest on this philosophy and attitudes.

This fundamental mind-set is often evident in later success. The anchoring of this vision goes beyond all the critical nuts-and-bolts issues covered in the chapters and cases on the opportunity, the business plan, financing, and so forth. Each of these issues is vital, but each by itself may not lead to success. A single factor rarely, if ever, does.

The capacity of the lead entrepreneur to craft a vision and then to lead, inspire, persuade, and cajole key people to sign up for and deliver the dream makes an enormous difference between success and failure, between loss and profit, and between substantial harvest and “turning over the keys” to get out from under large personal guarantees of debt. Henry Mitzberg reminds us: “the vision can develop in an emergent fashion, within the new organization, as the founding leader learns from his or her experience.”⁵

Marnie Walker grew Student Express, a special needs bussing company, to over \$10 million in revenue, 300 employees, and a fleet of 250 vehicles before being offered more money for her start-up than she could say “no” to. Perhaps the words of others best capture Marnie Walker’s ability to assemble and rally a cohesive group. According to one member of her team, Sheila Gallagher, operations manager at Student Express: “I was given the opportunity to learn and grow under her leadership. Marnie allows everyone to develop their own style through excellent team leadership and project management skills.” A colleague and leadership consultant, Elaine Todres, indicates: “Marnie is straightforward, honest, incisive, focused, driven by the needs of the others, results-oriented, compassionate and devoted to her people.” And even a customer from the York District School Board remarked: “She showed she really cared about our community, students, their parents and staff by helping out on committees and giving advice. She became part of our team.”

Instilling a vision, and the passion to win, occurs very early, often during informal discussions, and seems to trigger a series of self-fulfilling prophecies that lead to success, rather than to “almosts” or to failure. In a study to determine the actual existence of lead entrepreneurs in INC. 500 firms, it was found that among macro-entrepreneurial teams, lead entrepreneurs do exist and they have stronger entrepreneurial vision and greater self-efficacy or self-confidence to act on their vision and make it real.⁶

Thus, lead entrepreneurs and team members who understand team building and teamwork have a secret weapon. Many with outstanding technical or other relevant skills, educational credentials, and so on, will be at once prisoners and victims of the highly individualistic competitiveness that got them to where they are. They may be fantastic lone achievers, and some may even “talk a good team game.” But when it comes to how they behave and perform, their egos can rarely fit inside an airplane hangar. They simply do not have the team mentality.

What are these team philosophies and attitudes that the best entrepreneurs have and are able to identify or instill in prospective partners and team members? These can be traced to the entrepreneurial mind-set discussed in Chapter 1—a mind-set that can be seen actively at work around the team-building challenge. While there are innumerable blends and variations, most likely the teams of those firms that succeed in growing up big will share many of the following:

- **Cohesion.** Members of a team believe they are all in this together, and if the company wins, everyone wins. Members believe that no one can win unless everyone wins and, conversely, if anyone loses, everyone loses. Rewards, compensation, and incentive structures rest on building company value and return on capital invested, no matter how small or sizeable. Mahshad Koohgoli sums it up thus, “It’s not about the path of least resistance. If it’s easy, everybody else will be doing it...we are doing something that people said couldn’t be done. Starting a company is not easy. But it’s fun; I wouldn’t change it for anything else.”⁷
- **Teamwork.** A team that works as a team, rather than one where individual heroes are created, may be the single most distinguishing feature of the higher-potential venture. Thus, on these teams, efforts are made to make others’ jobs easier, to make heroes out of partners and key people, and to motivate people by celebrating their successes. As Harold Seigle, the highly successful, now retired, president and chief executive officer of the Sunmark Companies, likes to put it, “High performance breeds strong friendships!”
- **Integrity.** Hard choices and trade-offs are made regarding what is good for the customer, the company, and value creation, rather than being based on purely utilitarian or Machiavellian ethics or narrow personal or departmental needs and concerns. There is a belief in and commitment to the notion of getting the job done without sacrificing quality, health, or personal standards. Of Marnie Walker introduced earlier, Elaine

Todres added: “She is ethical and hardworking. And most enduring of all, Marnie is modest and seeks to learn continuously.” Marnie herself revealed that her aim is always to develop a culture of respect and accountability and to focus on long-term relationships.

- **Commitment to the long haul.** Like most organizations, new ventures thrive or wither according to the level of commitment of their teams. Members of a committed team believe they are playing for the long haul and that the venture is not a get-rich-quick drill. Rather, the venture is viewed as a delayed-gratification game in which it can take 5, 7, or even 10 or more years to realize a harvest. *No one gets a windfall profit by signing up now but bailing out early or when the going gets tough.* Stock-vesting agreements reflect this commitment. For example, stock will usually be so vested over five or seven years that anyone who leaves early, for whatever reasons, can keep stock earned to date, but he or she is required to sell the remaining shares back to the company at the price originally paid. Of course, such a vesting agreement usually provides that if the company is unexpectedly sold or if a public offering is made long before the five-or-seven-year vesting period is up, then stock is 100 percent vested automatically with that event. Pat Quinn, former NHL player and coach sums up teamwork: “The big thing is commitment as a group. You have to develop trust amongst each other that revolves around that commitment, that onus on each other to be honest and have that common direction that the team all want to go to.”
- **Harvest mind-set.** A successful harvest is the name of the game. This means that eventual capital gain is viewed as the scorecard, rather than the size of a monthly paycheque, the location and size of an office, a certain car, or the like. Dan Martell founded Spheric Technologies in Moncton, New Brunswick, in 2004. Spheric Technologies creates social network applications for corporations, essentially “Myspace for big business without the music.” His venture grew to 28 full-time employees and revenues of more than \$2.2 million in 2008. Mid-way through that year Dan Martell sold the venture and moved to other things—he co-founded Flowtown. He remains a senior advisor to Spheric Technologies, but in 2009 Spheric Technologies was forced to lay off another round of workers taking them down to 11 full-time employees.⁸
- **Commitment to value creation.** Team members are committed to value creation—making the pie bigger for everyone, including adding value for customers, enabling suppliers to win as the team succeeds, and making money for the team’s constituencies and various stakeholders. Harry Chemko and Jason Billingsley graduated from university in 2000 and launched a consulting business for companies wanting an Internet presence. Soon they noticed a demand for online shopping software and jumped at it. They changed the venture’s name and mission. Elastic Path’s e-commerce platform is used by Aeroplan, Time Inc., Avis, Samsonite, and the Vancouver 2010 Olympic and Paralympic Winter Games. With approximately 200 customers worldwide, a staff of over 100, and \$10 million in revenue they were identified by the *Financial Post* as a firm that would grow despite the economic slump of 2009–2010.⁹ Vancouver-based Elastic Path has remained privately held and has grown organically without outside capital, but it has partnered extensively in order to expand internationally.
- **Equal inequality.** In successful emerging companies, democracy and blind equality generally do not work very well, and diligent efforts are made to determine who has what responsibility for the key tasks. The president is the one to set the ground rules and to shape the climate and culture of the venture. Bill Foster, founder of Stratus Computer, was asked if he and his partners were all equal. He quipped, “Yes, we are, except I get paid the most and I own the most stock.” Stock is usually not divided equally among the founders and key managers. In one company of four key people, stock was split as follows: 34 percent for the president, 23 percent each for the marketing and technical vice presidents, and 6 percent for the controller. The remainder went to outside directors and advisors. In another company, seven founders split the company as follows: 22 percent for the president, 15 percent for each of the four vice presidents, and 9 percent for each of the two other contributors. An example of how failure to differentiate in terms of ownership impacts a business is seen in a third firm, where four owners each had equal share. Yet, two of the owners contributed virtually

everything, while the other two actually detracted from the business. Because of this unresolved problem, the company could not attract venture capital and was never able to grow significantly.

- **Fairness.** Rewards for key employees and stock ownership are based on contribution, performance, and results over time. Since these can only be roughly estimated in advance, and since there will invariably be surprises and inequities, both positive and negative, as time goes on, adjustments are made. One good example is a company that achieved spectacular results in just two years in the cellular phone business. When the company was sold, it was evident that two of the six team members had contributed more than was reflected in their stock ownership position. To remedy this, another team member gave one of the two team members stock worth several hundred thousand dollars. Since the team was involved in another venture, the president made adjustments in the various ownership positions in the new venture, with each member's concurrence, to adjust for past inequities. In addition, it was decided to set aside 10 percent of the next venture to provide some discretion in making future adjustments for unanticipated contributions to ultimate success.
- **Sharing of the harvest.** This sense of fairness and justness seems to be extended by the more successful entrepreneurs to the harvest of a company, even when there is no legal or ethical obligation to do so. For example, as much as 10 to 20 percent of the "winnings" is frequently set aside to distribute to key employees. In one such recent harvest, employees were startled and awash with glee when informed they would each receive a year's salary after the company was sold. However, this is not always the case. In another firm, 90 percent of which was owned by an entrepreneur and his family, the president, who was the single person most responsible for the firm's success and spectacular valuation, needed to expend considerable effort to get the owners to agree to give bonuses to other key employees of around \$3 million, an amount just over 1 percent of the \$250-million sale price. (It is worth considering how this sense of fairness, or lack of it, affects future flows of quality people and opportunities from which these entrepreneurs can choose new ventures.)

A Process of Evolution

An entrepreneur considering issues of team formation will rarely discover black-and-white, bullet-proof answers that hold up over time. Nor is it being suggested that an entrepreneur needs answers to all questions concerning what the opportunity requires, and when, before moving ahead. Emphasis on the importance of new venture teams also does not mean every new venture must start with a full team that plunges into the business. It may take some time for the team to come together as a firm grows, and there will also always be some doubt, a hope for more than a prospective partner can deliver, and a constant recalibration. Again, creative acts, such as running a marathon or entrepreneuring, will be full of unknowns, new ground, and surprises. Preparation is an insurance policy, and thinking through these team issues and team-building concepts in advance is very inexpensive insurance.

The combination of the right team of people and a right venture opportunity can be very powerful. The whole is, in such instances, greater than the sum of the parts. However, the odds for highly successful venture teams are rather thin. Even if a venture survives, the turnover among team members during the early years probably exceeds the national divorce rate. Studies of new venture teams seeking venture capital show many never get off the ground. These usually exhaust their own resources and commitment before raising the venture capital necessary to launch their ventures. Of those that are funded, about 1 in 20 becomes very successful in three to five years, in that it will return in excess of five times the original investment in realizable capital gains.

The formation and development of new venture teams seems to be idiosyncratic, and there seems to be a multitude of ways in which venture partners come together. Some teams form by accidents of geography, common interest, or working together (see Angstrom's Team on the next page). Perhaps the common interest is simply that the team members

want to start a business, while in other instances the interest is an idea that members believe responds to a market need. Others form teams by virtue of past friendships. For example, roommates or close friendships in college or graduate school frequently lead to business partnerships. This was the case with two of Jeffrey Timmons's MBA classmates who concluded that they would go into business together after rooming together for a week. Leslie Charm and Carl Youngman have been partners for over 35 years as owners of three national franchise companies, an entrepreneurial advisory and troubled-business-management company, and a venture capital company. Jiffy Lube was founded by college football coach Jim Hindman and some of his coaches and players—including Stephen Spinelli.

In the evolution of venture teams, two distinct patterns are identifiable. In the first, one person has an idea (or simply wants to start a business), and then three or four associates join the team over the next one to three years as the venture takes form. Alternatively, an entire team forms at the outset based on such factors as a shared idea, a friendship, an experience, and so forth.

Angstrom's Team

Angstrom Power Inc., located in North Vancouver, British Columbia, is a privately held enterprise "funded by venture partners with experience in advancing new energy technology" (www.angstrompower.com). Angstrom's aim was to bring to market an integrated hydrogen fuel cell, with energy storage and microfluid components for hand-held portable electronics (e.g., smart phone). Take a look at the following individuals and their backgrounds. There are commonalities and differences in their areas of expertise and many have overlapped in working at various organizations.

Paul Zimmerman, CEO, had built and run global businesses for the past 20 years. Paul brings to Angstrom contacts in the technology community (president of Oregon Scientific, senior executive at Cisco Systems, general manager at Samsung Electronics) as well as venture capital arena—including being a founding director of a \$2-billion equity fund. His schooling included the University of Toronto (electrical engineering and computer science) and an executive MBA from the International Institute of Management Development in Switzerland.

Dr. Ged McLean, founder, president, and CTO, was director of the Institute for Integrated Energy Systems at the University of Victoria, holds 40 patents and applications. He has past experience in start-up ventures.

Godfrey Forssman, director of Finance, is a Chartered Accountant with 12 years experience in growing entrepreneurial ventures.

Dr. Jeremy Schrooten, director of Fuel Cell Systems, B.Sc. degrees in chemistry and ceramic engineering and a Ph.D. in materials science. He previously worked at UTC Fuel Cells. He is credited with four patents before Angstrom and two while at Angstrom.

Olen Vanderleeden, director of Business Development, B.Eng. from the University of Victoria and an M.B.A. from Simon Fraser University. He worked at Ballard Power for eight years. He holds 11 patents and applications while at Ballard and seven while with Angstrom.

André van Vuuren, director of Engineering, has a background in new product development from prototype through volume production.

Bruce Townson, director of Strategy and Infrastructure, previously worked in partnership development in the hydrogen and fuel cell industries.

Joerg Zimmermann, director of Fueling R&D, worked in the R&D department of Ballard Power Systems for six years before joining Angstrom. He is a named inventor on 25 patents and patents pending.

To the above lineup listed on the venture's Web site in 2008, the following individuals were added in 2009 and Bruce Townson was removed!

John Lee, COO, 25 years of management experience at electrical and power technology companies—including alternative energy.

Jim McBeth, director of Manufacturing Engineering, worked in a variety of industry positions including as a director general with the National Research Council of Canada.

Steven Pratt, director of Engineering, has 15 years of experience in maturing and commercializing emerging technologies and holds more than 40 patents.

Angstrom's Board of Directors:

Chairman: Ake Almgren, Ph.D., serves on other boards, 26-year career at ABB, a worldwide power solutions company. President and CEO of Capstone Turbine 1998–2003.

David Oxtoby, CFA, worked for Ontario Power Generation Ventures, Inc. from 2001–2005. He is currently CEO of CarbonFree Technology Inc.

David Berkowitz has been with Ventures West since 1996 and leads the firm's cleantech practice.

Wal van Lierop, Ph.D., is co-founder, president, and CEO of Chrysalix Energy Venture Capital.

Mark Steinley, was originally Angstrom's president and CEO, while Ged McLean served as CTO, and helped secure the venture's first round of financing (\$2.85 million in 2002).

Eric Schwitzer, managing partner at Enterprise Capital Management Inc.

Daniel Muzyka, Ph.D., dean Sauder School of Business, University of British Columbia.

Sources: Angstrom Power's Web site, www.angstrom.com/, LinkedIn public listing for Angstrom Power, BusinessWeek Private Company listing for Angstrom Power Inc.

Filling the Gaps

There is no simple cookbook solution to team formation; rather, there are as many approaches to forming teams as there are ventures with multiple founders.

Successful entrepreneurs search out people and form and build a team based on what the opportunity requires, and when.¹⁰ Team members will contribute high value to a venture if they complement and balance the lead entrepreneur—and each other. Yet, ironically, while a substantial amount of thought usually accompanies the decision of people to go into business together, an overabundance of the thinking, particularly among the less experienced, can focus on less critical issues, such as titles, corporate name, letterhead, or what kind of lawyer or accountant is needed. Thus, teams are often ill-conceived from the outset and can easily plunge headlong into unanticipated and unplanned responses to crises, conflicts, and changes. Just as it is possible to recruit additions to the team from competitors or former employers, it should be noted that it is easy to lose team members that way too. Employees will leave to pursue their own best opportunities.¹¹

A team starts with a lead entrepreneur (Ged McLean in the case of Angstrom Power Inc.). In a start-up situation, the lead entrepreneur usually wears many hats. Beyond that, comparison of the nature and demands of the venture and the capabilities, motivations, and interests of the lead entrepreneur will signal gaps that exist and that need to be filled by other

team members or by accessing other outside resources, such as a board of directors (see Angstrom's board of directors), consultants, lawyers, accountants, and so on.¹² Elicia Maine, Daniel Shapiro, and Aidan Vining all of Simon Fraser University examined the relationship between clusters and the growth performance of firms. New ventures benefit by having access through proximity to a pool of valuable resources.¹³ Tod Rutherford of Syracuse University and John Holmes of Queen's University observe "entrepreneurs are active creators of institutional cluster development," but established firms erect barriers to protect their intellectual property, in an attempt to reduce tacit knowledge flows within the cluster.¹⁴

Serial entrepreneur, Mahshad Koohgoli, CEO of Protecode, has a product that examines a software developer's project and inspects the content to determine the underlying intellectual property and licensing attributes. With so much opensource software it is important to trace the content for ownership. Lawsuits were filed against Cisco for including some software that was in the public domain.¹⁵

Mark Dowds, launched BrainPark to make the workplace more collaborative, transparent, and efficient; the goal is to reduce information overload and keep things simple. But collaboration was not only part of the end product, Dowds has used crowdsourcing through blogs and other venues for assistance in designing and promoting his venture. He has also created IndoorPlayground, a physical space for the entrepreneur in need of office space (perhaps to hold a meeting) or the camaraderie and support of others working on start-ups.

Thus, for example, if the strengths of the lead entrepreneur or a team member are technical in nature, other team members, or outside resources, need to fill voids in marketing, finance, and such (see Angstrom's Team). Realistically, there will be an overlapping and sharing of responsibilities, but team members need to complement, not duplicate, the lead entrepreneur's capabilities and those of other team members.

Note that a by-product of forming a team may be alteration of an entry strategy if a critical gap cannot be filled. For example, a firm may find that it simply cannot assault a certain market because it cannot hire the right marketing person. But it may find it could attract a top-notch person to exploit another niche with a modified product or service.

Most important, the process of evaluating and deciding who is needed, and when, is dynamic and not a onetime event. What know-how, skills, and expertise are required? What key tasks and action steps need to be taken? What are the requisites for success? What is the firm's distinctive competence? What external contacts are required? How extensive and how critical are the gaps? How much can the venture afford to pay? Will the venture gain access to the expertise it needs through additions to its board of directors (see Angstrom's board of directors) or outside consultants? Questions such as these determine when and how these needs could be filled. And answers to such questions will change over time.

The following, organized around the analytical framework introduced in Chapter 2, can guide the formation of new venture teams.

The Founder What kind of team is needed depends upon the nature of the opportunity and what the lead entrepreneur brings to the game. One key step in forming a team is for the lead entrepreneur to assess his or her entrepreneurial strategy. (The personal entrepreneurial strategy exercise for Chapter 1—found online at www.mcgrawhill.ca/olc/timmons—is a valuable input in approaching these issues.) Thus, the lead entrepreneur needs to first consider whether the team is desirable or necessary and whether he or she wants to grow a higher potential company. He or she then needs to assess what talents, know-how, skills, track record, contacts, and resources are being brought to the table; that is, what "chunks" have been acquired. (See the leadership skills and know-how assessment exercise for Chapter 5.) Once this is determined, the lead entrepreneur needs to consider what the venture has to have to succeed, who is needed to complement him or her, and when. The best entrepreneurs are optimistic realists and have a desire to improve their performance. They work at knowing what they do and do not know and are honest with themselves. The lead entrepreneur needs to consider issues such as:

- What relevant industry, market, and technological know-how and experience are needed to win, and do I bring these to the venture? Do I know the revenue and cost model better than anyone?

- Are my personal and business strengths in those specific areas critical to success in the proposed business?
- Do I have the contacts and networks needed (and will the ones I have make a competitive difference), or do I look to partners in this area?
- Can I attract a "first team" of all-star partners inside and externally, and can I lead these people and other team members effectively?
- Why did I decide to pursue this particular opportunity now, and what do I want out of the business (i.e., what are my goals and my income and harvest aspirations)?
- Do I know what the sacrifices and commitment will be, and am I prepared to make these?
- What are the risks and rewards involved, am I comfortable with them, and do I look for someone with a different risk-taking orientation?

Often a student going through this process will conclude that a more experienced person will be needed to lead the venture.

The Opportunity The need for team members is something an entrepreneur constantly thinks about, especially in the idea stage before start-up. What is needed in the way of a team depends on the matchup between the lead entrepreneur and the opportunity, and how fast and aggressively he or she plans to proceed. (See the online Venture Opportunity Screening Exercises for Chapter 3.) While most new ventures plan to bootstrap it and bring on additional team members only as the company can afford them, the Catch-22 is that if a venture is looking for venture capital or serious private investors, having an established team will yield higher valuation and a smaller ownership share that will have to be parted with. Some questions that need to be considered are:

- Have I clearly defined the value added and the economics of the business? Have I considered how (and with whom) the venture can make money in this business? For instance, whether a company is selling razors or razor blades makes a difference in the need for different team members.
- What are the critical success variables in the business I want to start, and what (or who) is needed to influence these variables positively?
- Do I have, or have access to, the critical external relationships with investors, lawyers, bankers, customers, suppliers, regulatory agencies, and so forth, that are necessary to pursue my opportunity? Do I need help in this area?
- What competitive advantage and strategy should I focus on? What people are necessary to pursue this strategy or advantage?

Outside Resources In reaction to corporate scandals (e.g., Bre-X, Hollinger, Nortel), governance issues have become more important in recent years, including for start-up enterprises.¹⁶ Gaps can be filled by accessing outside resources, such as boards of directors, accountants, lawyers, consultants, and so forth.¹⁷ Usually, tax and legal expertise can best be obtained initially on a part-time basis. Other expertise (e.g., to design an inventory control system) is specialized and needed only once. Generally, if the resource is a onetime or periodic effort, or if the need is peripheral to the key tasks, goals, and activities required by the business, then an alternative such as using consultants makes sense. However, if the expertise is a must for the venture at the outset and the lead entrepreneur cannot provide it or learn it quickly, then one or more people will have to be acquired. Some questions to consider are:

- Is the need for specialized, one-time, or part-time expertise peripheral or on the critical path?
- Will trade secrets be compromised if I obtain this expertise externally?

Additional Considerations

Forming and building a team is, like marriage, a rather unscientific, occasionally unpredictable, and frequently surprising exercise—no matter how hard one may try to make it otherwise! The analogy of marriage and family, with all the accompanying complexities and consequences, is a particularly useful one. Forming a team has many of the characteristics of the courtship and marriage ritual, involving decisions based in part on emotion. There may well be a certain infatuation among team members and an aura of admiration, respect, and often fierce loyalty. Similarly, the complex psychological joys, frustrations, and uncertainties that accompany the birth and raising of children (here, the product or service) are experienced in entrepreneurial teams as well. Thus, the following additional issues need to be considered:

- **Values, goals, and commitment.** It is critical that a team be well anchored in terms of values and goals. In any new venture, the participants establish psychological contracts and climates. While these are most often set when the lead entrepreneur encourages standards of excellence and respect for team members' contributions, selection of team members whose goals and values are in agreement can greatly facilitate establishment of a psychological contract and an entrepreneurial climate. In successful companies, the personal goals and values of team members align well, and the goals of the company are championed by team members as well. While this alignment may be less exact in large publicly owned corporations and greatest in small closely held firms, significant overlapping of a team member's goals with those of other team members and the overlap of corporate goals and team members' goals is desirable. Practically speaking, these evaluations of team members are some of the most difficult to make.
- **Definition of roles.** A diligent effort needs to be made to determine who is comfortable with and who has what responsibility for the key tasks so duplication of capabilities or responsibilities is minimized. Roles cannot be pinned down precisely for all tasks, since some key tasks and problems simply cannot be anticipated and since contributions are not always made by people originally expected to make them. Maintaining a loose, flexible, flat structure with shared responsibility and information is desirable for utilizing individual strengths, flexibility, rapid learning, and responsive decision-making.
- **Peer groups.** The support and approval of family, friends, and co-workers can be helpful, especially when adversity strikes. Reference group approval can be a significant source of positive reinforcement for a person's career choice and, thus, his or her entire self-image and identity.¹⁸ Ideally, peer group support for each team member should be there. (If it is not, the lead entrepreneur may have to accept the additional burden of encouragement and support in hard times, a burden that can be sizeable.) Therefore, questions of whether a prospective team member's spouse is solidly in favour of his or her decision to pursue an entrepreneurial career and the sweat equity required and of whether the team member's close friends will be a source of support and encouragement or of detraction or negativism need to be considered.

Common Pitfalls

There can be difficulties in the practical implementation of these philosophies and attitudes, irrespective of the venture opportunity and the people involved. The company may come unglued before it gets started, may experience infant mortality, or may live perpetually immersed in nasty divisive conflicts and power struggles that will cripple its potential, even if they do not kill the company.

Often, a team lacks skill and experience in dealing with such difficult start-up issues, does not take the time to go through an extended "mating dance" among potential partners during the moonlighting phase before actually launching the venture, or does not seek the advice of competent advisors. As a result, such a team may be unable to deal with such sensitive issues as who gets how much ownership, who will commit what time and money or other resources, how disagreements will be resolved, and how a team member can leave or be let go. Thus, crucial early discussions among team members sometimes lead to a

premature disbanding of promising teams with sound business ideas. Or in the rush to get going, or because the funds to pay for help in these areas are lacking, a team may stay together but not work through, even in a rough way, many of these issues. Such teams do not take advantage of the moonlighting phase to test the commitment and contribution made by team members. For example, to build a substantial business, a partner needs to be totally committed to the venture. The success of the venture is the partner's most important goal, and other priorities, including his or her family, come second. Another advantage of using such a shakedown period effectively is that the risks inherent in such factors as premature commitment to permanent decisions regarding salary and stock are lower.

The common approach to forming a new venture team also can be a common pitfall for new venture teams. Here, two to four entrepreneurs, usually friends or work acquaintances, decide to demonstrate their equality with such democratic trimmings as equal stock ownership, equal salaries, equal office space and cars, and other items symbolizing their peer status. Left unanswered are questions of who is in charge, who makes the final decisions, and how real differences of opinion are resolved. While some overlapping of roles and a sharing in and negotiating of decisions are desirable in new venture teams, too much looseness is debilitating. Even sophisticated buy-sell agreements among partners often fail to resolve the conflicts.

Another pitfall is a belief that there are no deficiencies in the lead entrepreneur or the management team. Or a team is overly fascinated with or overcommitted to a product idea. For example, a lead entrepreneur who is unwilling or unable to identify his or her own deficiencies and weaknesses and to add appropriate team members to compensate for these, and who further lacks an understanding of what is really needed to make a new venture grow into a successful business, has fallen into this pitfall.¹⁹

Failing to recognize that creating and building a new venture is a dynamic process is a problem for some teams. Therefore, such teams fail to realize that initial agreements are likely not to reflect actual contributions of team members over time, regardless of how much time one devotes to team-building tasks and regardless of the agreements team members make before start-up. In addition, they fail to consider that teams are likely to change in composition over time. Richard Testa, a leading attorney whose firm has dealt with many start-ups and with numerous venture capital firms, startled those attending a seminar on raising venture capital by saying:

The only thing that I can tell you with great certainty about this start-up business has to do with you and your partners. I can virtually guarantee you, based on our decade plus of experience, that five years from now at least one of the founders will have left every company represented here today.²⁰

Woe is the team that fails to put in place mechanisms that will facilitate and help structure graceful divorces and provide for the internal adjustments required as the venture grows.

Destructive motivations in investors, prospective team members, or the lead entrepreneur spell trouble. Teams suffer if they are not alert to signs of potentially destructive motivations, such as an early concern for power and control by a team member. In this context, it has been argued that conflict management is a central task for members of teams. A study of self-empowered teams found that how team members resolve their conflicts could affect their self-efficacy, as well as overall team performance. Team members in this study were most effective when they recognized they wanted to resolve the conflict for mutual benefit and that the goal is to help each other get what each other really needs and values, and not to try to win or to outdo each other.²¹

Finally, new venture teams may take trust for granted. Integrity is important in long-term business success, and the world is full of high-quality, ethical people; yet the real world also is inhabited by predators, crooks, sharks, frauds, and impostors. Chapter 7 contains a detailed discussion on the importance of integrity in entrepreneurial pursuits. It is paradoxical that an entrepreneur cannot succeed without trust, but he or she probably cannot succeed with blind trust either. Trust is something that is earned, usually slowly, for it requires a lot of patience and a lot of testing in the real world. This is undoubtedly a major reason why investors prefer to see teams that have worked closely together. In the area of trust, a little cynicism goes a long way, and teams that do not pay attention to detail, such as performing due diligence with respect to a person or firm, fall into this pit.

REWARDS AND INCENTIVES

Slicing the Founder's Pie

One of the most frequently asked questions from start-up entrepreneurs is: How much stock ownership should go to whom? (Chapter 9 "Financing the Venture" examines the various methods used by venture capitalists and investors to determine what share of the company is required by the investor at different rounds of investment.) Consider the recent discussions with Jed, a former student, who secured substantial early-stage funding from John Doerr of Kleiner Perkins Caufield & Byers. The advice for Jed and all others is the same.

First, start with a philosophy and set of values that boil down to this great principle: Share the wealth with those who help to create the value and thus the wealth. Once over that hurdle, you are less likely to get hung up on the percentage of ownership issue. After all, 51 percent of nothing is nothing. The key is making the pie as large as possible. Second, the ultimate goal of any venture-capital-backed company is to realize a harvest at a price 5 to 10 times the original investment, and up. Thus, the company will either be sold via an initial public offering (IPO) or to a larger company. It is useful to work backward from the capital structure at the time of the IPO to envision and define what will happen and who will get what. Most venture-capital-backed, smaller company IPOs during the robust capital markets of the late 1990s would have 12 to 15 million shares of stock outstanding after the IPO. In most situations 2.5 to 4 million shares are sold to the public (mostly to institutional investors) at \$12 to \$15 per share, depending on the perceived quality of the company and the robustness of the appetite for IPOs at the time. The number could be halved or doubled. Typically, the founder/CEO will own 1 to 3 million shares after the IPO, worth somewhere between \$12 and \$45 million. Put in this perspective, it is much easier to see why finding a great opportunity, building a great team, and sharing the wealth with widespread ownership in the team is far more important than what percentage of the company is owned.

Finally, especially for young entrepreneurs in their 20s or 30s, this will not be their last venture. The single most important thing is that it succeeds. Make this happen, and the future opportunities will be boundless. All this can be ruined if the founder/CEO simply gets greedy and overcontrolling, keeping most of the company to himself or herself, rather than creating a sizeable, shared pie.

The Reward System²²

The reward system of a new venture includes both the financial rewards of a venture—such as stock, salary, and fringe benefits—and the chance to realize personal growth and goals, exercise autonomy, and develop skills in particular venture roles. Also, what is perceived as a reward by any single team member will vary. This perception will depend very much upon personal values, goals, and aspirations. Some may seek long-range capital gains, while others desire more short-term security and income.

The reward system established for a new venture team should facilitate the interface of the venture opportunity and the management team. It needs to flow from team formation and enhance the entrepreneurial climate of the venture and the building of an effective team. For example, being able to attract and keep high-quality team members depends, to a great extent, on financial and psychological rewards given. The skills, experience, commitment, risk, concern, and so forth, of these team members are secured through these rewards.

The rewards available to an entrepreneurial team vary over the life of a venture. While intangible rewards, such as opportunity for self-development and realization, may be available throughout, some of the financial rewards are more or less appropriate at different stages of the venture's development.

Because these rewards are so important and because, in its early stages, a venture is limited in the rewards it can offer, the total reward system over the life of the venture needs to be thought through very carefully and efforts need to be made to ensure that the venture's capacity to reward is not limited as levels of contribution change or as new personnel are added.

External issues also have an impact on the reward system created for a new venture. The division of equity between the venture and external investors will affect how much equity is available to team members. Further, the way a venture deals with these questions also will determine its credibility with investors and others, because these people will look to the reward system for signs of commitment by the venture team.

Critical Issues

Dividing ownership among the founding team, based on the philosophy and vision discussed earlier, is an early critical task for the lead entrepreneur. Investors may provide advice but will, more often than not, dump the issue squarely back in the lap of the lead entrepreneur, since whether and how these delicate ownership decisions are resolved often is seen by investors as an important litmus test. Also, the process by which a reward system is decided and the commitment of each team member to deal with problems in a way that will ensure rewards continue to reflect performance are of utmost importance. Each key team member needs to be committed to working out solutions that reflect the commitments, risks, and anticipated relative contributions of team members as fairly as possible.²³

A good reward system reflects the goals of the particular venture and is in tune with valuations. If a venture is not seeking outside capital, outside owners need not be considered; but the same issues need to be resolved. For example, if a goal is to realize a substantial capital gain from the venture in the next 5 to 10 years, then the reward system needs to be aimed at reinforcing this goal and encouraging the long-term commitment required for its attainment.

No time-tested formulas or simple answers exist to cover all questions of how distributions should be made. However, the following issues should be considered:

- **Differentiation.** The democracy approach can work, but it involves higher risk and more pitfalls than a system that differentiates based on the value of contributions by team members. As a rule, different team members rarely contribute the same amount to the venture, and the reward system needs to recognize these differences.
- **Performance.** Reward needs to be a function of performance (as opposed to effort) during the early life of the venture and not during only one part of this period. Many ventures have been torn apart when the relative contributions of the team members changed dramatically several years after start-up without a significant change in rewards. (Vesting goes a long way toward dealing with this issue.)
- **Flexibility.** Regardless of the contribution of any team member at any given time, the probability is high that this will change. The performance of a team member may be substantially more or less than anticipated. Further, a team member may have to be replaced and someone may have to be recruited and added to the existing team. Flexibility in the reward system, including such mechanisms as vesting and setting aside a portion of stock for future adjustments, can help to provide a sense of justice.

Considerations of Timing

Division of rewards, such as the split of stock between the members of the entrepreneurial team, will most likely be made very early in the life of the venture. Rewards may be a way of attracting significant early contribution; however, it is performance over the life of the venture that needs to be rewarded.

For example, regarding equity, once the allocation of stock is decided, changes in the relative stock positions of team members will be infrequent. New team members or external investors may dilute each member's position, but the relative positions will probably remain unchanged.

However, one or more events may occur during the early years of a venture. First, a team member who has a substantial portion of stock may not perform and need to be replaced early in the venture. A key team member may find a better opportunity and quit, or a key

team member could die in an accident. In each of these instances, the team will then be faced with the question of what will happen to the stock held by the team member. In each case, stock was intended as a reward for performance by the team member during the first several years of the venture, but the team member will not perform over this time period.

Several mechanisms are available to a venture when the initial stock split is so made to avoid the loss or freezing of equity. A venture can retain an option of returning stock to its treasury at the price at which it was purchased in certain cases, such as when a team member needs to be replaced. A buyback agreement also achieves this purpose.

To guard against the event that some portion of the stock has been earned and some portion will remain unearned, as when a team member quits or dies, the venture can place stock purchased by team members in escrow to be released over a two- or three-year period. Such a mechanism is called a stock-vesting agreement, and such an agreement can foster longer-term commitment to the success of the venture, while also providing a method for a civilized no-fault corporate divorce if things do not work out. Such a stock-vesting agreement is attached as a restriction on the stock certificate. Typically, the vesting agreement establishes a period of years, often four or more. During this period, the founding stockholders can "earn out" their shares. If a founder decides to leave the company before completion of the four-year vesting period, he or she may be required to sell the stock back to the company for the price originally paid for it, usually nothing. The departing shareholder, in this instance, would not own any stock after the departure. Nor would any capital gain windfall be realized by the departing founder. In other cases, founders may vest a certain portion each year, so they have some shares even if they leave. Such vesting can be weighted toward the last year or two of the vesting period. Other restrictions can give management and the board control over the disposition of stock, whether the stockholder stays or leaves the company. In essence, a mechanism such as a stock-vesting agreement confronts team members with the reality that "this is not a get-rich-quick exercise."

Other rewards, such as salary, stock options, bonuses, and fringe benefits, can be manipulated more readily to reflect changes in performance. But the ability to manipulate these is also somewhat dependent upon the stage of development of the venture. In the case of cash rewards, there is a trade-off between giving cash and the growth of the venture. Thus, in the early months of a venture, salaries will necessarily be low or nonexistent, and bonuses and other fringe benefits usually will be out of the question. Salaries, bonuses, and fringe benefits all drain cash, and until profitability is achieved, cash can always be put to use for operations. After profitability is achieved, cash payments will still limit growth. Salaries can become competitive once the venture has passed breakeven, but bonuses and fringe benefits should probably be kept at a minimum until several years of profitability have been demonstrated.

Mahshad Koohgoli advocates strict adherence to checkpoints. On the subject of timing with regard to his young venture Protecode, he revealed "We are keeping our focus. I've got 18 people in here right now. Eighteen payrolls; 18 families. I have no right to mislead them. I have no right to mislead myself. I hate to waste my time in life. Doing things quickly is very good. Something I've heard is 'you want to fail fast if you have to fail'—you don't want to drag it on for years." Koohgoli sees a statute of limitations, "If two years have gone by and nothing's happened, there's something wrong."²⁴ Finally, Eugene Kleiner, pioneer of venture capitalism asserts, "There is a time when panic is the appropriate response."

Considerations of Value

The contributions of team members will vary in nature, extent, and timing. In developing the reward system, particularly the distribution of stock, contributions in certain areas are of particular value to a venture, as follows:

- **Idea.** In this area, the originator of the idea, particularly if trade secrets or special technology for a prototype was developed or if product or market research was done, needs to be considered.
- **Business plan preparation.** Preparing an acceptable business plan, in terms of dollars and hours expended, needs to be considered.

- **Commitment and risk.** A team member may invest a large percentage of his or her net worth in the company, be at risk if the company fails, have to make personal sacrifices, put in long hours and major effort, risk his or her reputation, accept reduced salary, or already have spent a large amount of time on behalf of the venture. This commitment and risk need to be considered.
- **Skills, experience, track record, or contacts.** A team member may bring to the venture skills, experience, track record, or contacts in such areas as marketing, finance, and technology. If these are of critical importance to the new venture and are not readily available, these need to be considered.
- **Responsibility.** The importance of a team member's role to the success of the venture needs to be considered.

Being the originator of the idea or expending a great amount of time or money in preparing the business plan is frequently overvalued. If these factors are evaluated in terms of the real success of the venture down the road, it is difficult to justify much more than 15 to 20 percent of equity for them. Commitment and risk, skills, experience, and responsibility contribute more by far to the success of a venture.

The above list is valuable in attempting to weigh fairly the relative contributions of each team member. Contributions in each of these areas have some value; it is up to a team to agree on how to assign value to contributions and, further, to leave enough flexibility to allow for changes.

INTERNET IMPACT: TEAM

Attracting Talent

The Internet is quickly changing the economics and capabilities of the job market. The ease and low cost of posting detailed employment openings, the extremely large databases of job seekers, and the speed of candidate response have many hiring managers and entrepreneurs devoting more time than ever before to recruiting online.

Since employers can delimit résumé searches to specified skill sets, years of experience, and salary requirements with a few keystrokes, a single Internet site such as Monster.com can serve as a targeted recruiting engine that is equal to a dozen or more recruiters. Jeff Taylor, Monster.com's founder and CEO, commented, "Post an opening for somebody fluent in Japanese and English, and you're as apt to hear from applicants in Tokyo and Dublin as from those in Los Angeles. We get 11 million visitors a month, and in many cases, small businesses get as many as 400 responses from one posting."

Web sites representing professional associations such as Women in Technology International (www.witi.com) also have large databases of qualified individuals. These sites will often post job openings for a nominal fee.

Chapter Summary

1. A strong team is usually the difference between a success and a marginal or failed venture, and between a so-so and a great company.
2. Core philosophies, values, and attitudes, particularly sharing the wealth and ownership with those who create it, are key to team building.
3. The fit concept is central to anticipating management gaps and building the team.²⁵
4. Numerous pitfalls await the entrepreneur in team building and need to be avoided. The lead entrepreneur and the entire team need to remain vigilant in their honest assessment of immediate and potential pitfalls.
5. Compensating and rewarding team members requires both a philosophy and technical know-how, and can have enormous impact on the odds of success.

Study Questions

1. Why is the team so important in the entrepreneurial process? How far can you get alone?
2. Describe what is meant by "team" philosophy and attitudes. Why are these important? How is this different from the quip "teamwork is everyone doing what I say."
3. What are the most critical questions an entrepreneur needs to consider in thinking through the team issues? What are some common pitfalls in team building? Can they be avoided or prepared for?
4. What are the critical rewards, compensation, and incentive issues in putting a team together? Why are these so crucial and difficult to manage?
5. How does the lead entrepreneur allocate stock ownership and options in the new venture? Who should get what ownership and why?

Mind Stretchers Have you considered?

1. Think about a team in which you have been a member or a captain. What leadership and coaching principles characterized the most and least successful teams?
2. What is a team? What is its antithesis? Who is part of the team? Are suppliers and buyers included? What about competitors?
3. Even sole proprietors do not work alone. How do you see the fit between you and the team concept?
4. One expert insists that the only guarantee he can make to a start-up team is that in five years, at least one or two members will leave or be terminated. What causes this? Why will your team be different?
5. Ask five people who have worked with you in a team to give you feedback about your team-building skills.

EXERCISE Rewards

The following exercise can help an entrepreneur devise a reward system for a new venture. In proceeding with the exercise, it is helpful to look at these issues from an investor's point of view and to imagine that the venture is in the process of seeking capital from an investor group to which a presentation was made several weeks ago and which is favourably impressed by the team and its plan for the new venture. Imagine then that this investor group would like a brief presentation (of 10 to 15 minutes) about how the team plans to reward its members and other key contributors.

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Name: _____
 Venture: _____
 Date: _____

Part I

Part I is to be completed by each individual team member—*alone*.

Step 1 Indicate who will do what during the first year or two of your venture, what contributions each has made or will make to creating a business plan, the commitment and risk involved for each, and what unique critical skills, experience, contacts, and so forth, each brings to the venture. Try to be as specific as possible, and be sure to include yourself.

Team Member	Responsibility	Title	Contribution to Business Plan	Commitment and Risk	Unique/Critical Skills, etc.

Step 2 Indicate below the approximate salary and shares of stock (as a percent) each member should have upon closing the financing of your new venture.

Team Member	Salary	Shares of Stock (# and %)

Step 3 Indicate below what fringe benefits you believe the company should provide during the first year or two.

Team Member	Vacation	Holidays	Health/Life Insurance	Retirement Plan	Other

Step 4 List other key contributors, such as members of the board of directors, and indicate how they will be rewarded.

Name	Expertise/Contribution	Salary	Shares of Stock (# and %)	Other

Part II

Part II involves meeting as a team to reach consensus on the responsibilities of each team member and how each will be rewarded. In addition to devising a reward system for the team and other key contributors, the team will examine how consensus was reached.

Step 1 Meet as a team and reach consensus on the above team issues and indicate the consensus solution below.

Responsibilities/Contributions				
Team Member	Responsibility	Contribution to Business Plan	Commitment and Risk	Unique/Critical Skills, etc.

Rewards		
Team Member	Salary	Shares of Stock (# and %)

Rewards (continued)						
Team Member	Title	Vacation	Holidays	Health/Life Insurance	Retirement Plan	Other

Step 2 Meet as a team and reach consensus on issues involving other key contributors and indicate the consensus solution below.

Name	Expertise/Contribution	Salary	Shares of Stock (# and %)	Other

Step 3 Discuss as a team the following issues and indicate any important lessons and implications:

- What patterns emerged in the approaches taken by each team? What are the differences and similarities?
- How difficult or easy was it to reach agreement among team members? Did any issues bog down?
- If salaries or stock were equal for all team members, why was this so? What risks or problems might such an approach create?
- What criteria, either implicit or explicit, were used to arrive at a decision concerning salaries and stock? Why?

CASE MATCHA MEN

Preparation Questions

1. Evaluate the composition of Brian and Mars' team? Who is part of their team and who is not?
2. Are there any elements or individuals missing from their team? What characteristics or attributes should they be looking for in order to complete their team?
3. What should Brian and Mars do next?

Tea is in Brian Takeda's blood. His childhood memories are dotted with scenes of tea ceremonies with his grandmother, and his family lineage includes more than one Japanese tea master. So in 2001, when an entrepreneurship professor at an Ontario business school challenged Takeda and fellow student Mars Koo to develop a business plan for a new venture, Takeda's thoughts turned immediately to tea. Having seen Japan's fast-growing green tea market firsthand, he felt that North America was an untapped well of opportunity. The pair built a business plan that envisioned a chain of premium, fresh-brewed loose-leaf tea retailers across Canada and the United States.

East Meets West

Their model was an elegant meeting of East and West: the high-end teas of the Japanese salon and the chado ceremony, transplanted into the accessible, high-volume retail model of the café. The concept followed the lead of chains like Starbucks and Second Cup, offering customers premium products, a space for social gathering, and a focus on customer education. As Starbucks reshaped consumer tastes a decade earlier by promoting superior arabica premium beans, so Infuze planned to cultivate a Canadian taste for premium tea, far beyond flat, forgettable supermarket varieties.

In 2002, shortly after graduation, the pair began planning for a Vancouver-area store to test their concept. Their parents thought enough of their plan that they put up the \$200,000 they needed to get rolling. A short time later, Infuze Holdings had its first location—a spot in Vancouver's Gastown district, tucked amidst large hotels and shopping areas. Although cash was scarce, the company chose a high-end design group to create a sleek, Zen-inspired interior. It also hired a noted branding expert to develop a minimalist logo and packaging treatment. "It was expensive," Takeda admits. "But we always pledged to be the best at what we do, and to partner with those who are the best at what they do."

The obsession with quality extended to their products as well. When their first store opened in early 2003, Infuze offered a range of more than 50 freshly brewed loose-leaf teas. The selection included green, black, oolong and white teas, fruit and herb-infused teas, and iced tea. In each category, Infuze offered both premium and regular teas, distinguished by price (from \$1.50 to \$4 per cup) and by packaging. Introducing teas at super-premium price points was novel—at the time, even at chains such as Starbucks, tea was still served in bags at price levels ranging from \$1.30 to \$2.00. Yet Infuze's premium teas were exceptional, including rare Taiwanese oolongs and sen-

cha green teas. Even its lower-priced regular beverages used high-grade loose-leaf teas.

While Infuze had little money for marketing and promotion, its designs and products succeeded in attracting a discriminating and well-connected clientele. The founders, sensing an opportunity, began to leverage the knowledge and networks of those early customers. Within a month, Infuze-branded teas were being offered at a local boutique hotel and in tea-flavoured martinis at another stylish eatery.

Matcha

To further increase Infuze's prestige, Takeda and Koo gambled on a product that had almost no North American exposure—matcha. Matcha is a jade-green powder made by grinding shade-grown, hand-picked tea leaves and stems with granite wheels. It can be whisked with hot water for a frothy tea drink or used in blended drinks and baked goods. Matcha contains an amino acid called theanine, which is reputed to offer its users an energy boost similar to caffeine—but without causing the jitters. This tea is perhaps the world's best, and Infuze hoped that offering it would differentiate its menu and help encourage a culture of tea connoisseurship. It's also pricey. Shortly after its first store opened, Infuze launched its matcha-based drinks at prices ranging from \$3.50 for a whisked cup of matcha tea to \$5 for a matcha smoothie.

It wasn't long before good luck gave Takeda and Koo a boost. It turned out that many of their first customers were from the nearby offices of The Vancouver Sun. The store's uniqueness, coupled with the founders' penchant for giving customers lessons on their teas' history, cultivation, health benefits and flavour profiles, led to some immediate and favourable press coverage. The attention grew as the founders exploited their story. The media treated matcha as a made-in-Vancouver success, playing up Takeda's family history and the heresy of shilling tea in Starbucks country. Coverage continued to spread. "We've never sent out a press release," says Takeda. "We've never cold-called an editor."

Infuze had other advantages. Most significant was its exclusive distribution rights to matcha in Vancouver. In the company's planning stages, the founders secured a commitment from Aiya Corp. of Japan, the market leader in ceremonial green tea production. Side stepping usual distribution channels, Aiya pledged to offer just-in-time delivery of its high-end teas, which could otherwise be difficult to source and procure. Infuze was offered exclusivity in their area, giving its tea rooms a virtual monopoly on the green powder.

This case was written by Lukas Neville, Ph.D. student, Queen's School of Business, and Professor Elspeth J. Murray, CIBC Teaching Fellow in Entrepreneurship, Queen's School of Business, Queen's University. This case was developed with the support of the CIBC Curriculum Development Fund at the Queen's Centre for Business Venturing, for purposes of classroom discussion.

Before long, Infuze's business took a turn. Takeda and Koo knew that their pair of tea houses was too small to drive and sustain mainstream consumer demand for matcha alone. So even though their original business plan identified other retailers as a serious competitive threat, the duo found themselves supplying an increasing number of those same competitors with matcha powder. The biggest was a 40-store regional chain, which Takeda and Koo helped to develop its own matcha latte and "matcha chillo" drinks. This deal put matcha drinks into a competitor's store not five minutes away from one of their own.

Since Infuze was young, it was difficult for the founders to quantify the effects of this change in tactics—but they felt that wholesaling and retail beverage sales seemed to form a virtuous circle for the company. "Sure, we gave up being the only place in town for matcha," says Takeda. "But the more prevalent it was, the more popular it became. We were making money whether it was being sold wholesale or through our store, so it wasn't in our interests to clutch onto exclusivity on the retail side." With the chain's aggressive PR campaign, matcha grabbed national coverage. In less than six months, Infuze's bulk sales increased from 5 percent to 20 percent of gross revenue.

Even then, however, wholesale distribution was still a sideline. That changed after a meeting in late 2004. Takeda and Koo were invited to San Francisco to meet with senior decision-makers at a 500-location chain of smoothie stores. The smoothie giant was enthralled with matcha and was prepared to order it in bulk from Infuze in unprecedented volumes. It was also ready to move fast. "Product development in the beverage industry can be a year-long cycle," Takeda says. "They were ready to push it forward in three months."

But the new deal was fraught with peril. "There was nothing to stop our client from dealing with Aiya directly," said Takeda. "We were two guys in Vancouver working as middlemen between two massive corporations." And even if they could continue working with the client directly, Infuze stood to gain only a very modest markup on the cost of the bulk matcha—hardly commensurate with the resources Infuze was investing to close the deal.

By this time, Infuze had done a second round of financing. And Takeda and Koo's worries were echoed by their new investors, who insisted that Infuze's relationship with Aiya needed retooling. Infuze's management took their business case to Aiya: Infuze's bulk business was growing quickly, they had a 500-location chain waiting in the wings, but the present structure of the deal left Infuze no incentive for continuing to pursue bulk sales. Aiya responded with a "working understanding." Says Takeda: "Aiya basically promised me that we would find a fair way to share the risks and rewards of growing the matcha market. But they wouldn't commit to any details."

Aiya had a corporate culture that valued deliberation, and negotiations plodded on for months. Yet Infuze was still able to help its big, fast-moving client debut its matcha smoothie. The arrangement was held together by the good faith of Infuze's founders and two equity investments from Aiya as evidence of its commitment. Takeda, Koo, and their staff joined Aiya at trade fairs and conventions. Takeda and Koo were used to conveying matcha's value proposition clearly and concisely. "Behind the counter at Infuze, you've got 20 seconds of the customer's attention," Takeda says. They used their 20-second elevator pitch at the trade shows they attended to considerable effect. "We were getting 10 business cards for every one that Aiya's staff were getting."

New Deal

In May 2005, Aiya finally returned with a new deal for Infuze. The offer involved a five-year term, entitling Infuze to 33.3 percent of its gross margin for all sales to new or expanded Canadian and American accounts. Infuze, as a non-exclusive supplier and marketer, would be required to make "reasonable commercial efforts" to expand its own chain of branded tea houses, sell Aiya tea in its tea houses, and maximize North American sales.

The night they received Aiya's memorandum of understanding, Takeda and Koo stayed up late digesting its contents. Under its terms, Aiya and Infuze would share the cost of direct marketing and employees. Aiya would cover two-thirds of the costs and Infuze the remaining third. Infuze's spending would be subsidized by an injection of \$250,000 from Aiya, in exchange for a modest share of equity. "We were ecstatic. It was an unbelievable deal," says Takeda. "When we first talked with Aiya in January, they had been talking about performance milestones, contingent on growth levels. By the time we had a written deal, there were no performance requirements." The trust built during the two companies' long courtship allowed Aiya to feel comfortable with a flexible contract free of formal obligations beyond a commitment to revenue-sharing.

But for all their enthusiasm, Takeda and Koo were daunted by the road that lay ahead: Would Infuze miss its retail opportunity by moving into wholesale? What would it need to do to switch from retail to wholesaling? And how were two guys in Vancouver going to make Americans clamour for matcha and bring industry giants to their doorstep? "It was going to be a 180-degree turnaround in the direction of our business. And we needed strategy on the fly, in real time," says Takeda.

Infuze's founders were worn out and overwhelmed. They had been successful at retailing. Their first experiments in wholesaling had been extraordinarily promising. But were they ready to switch gears mid-race?

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7

ETHICAL DECISION MAKING AND THE ENTREPRENEUR

A creative man is motivated by the desire to achieve, not by the desire to beat others.

Ayn Rand

RESULTS EXPECTED

Upon completion of this chapter, you will be able to:

1. Make decisions involving ethical issues and analyze your reasons for doing so.
2. Discuss with others the ethical implications of the decisions you make and identify how they might affect you, your partners, your customers, and your competitors.
3. Recognize the importance of high ethical standards in an entrepreneurial career.

RESULTS EXPECTED

OVERVIEW OF ETHICS

Most successful entrepreneurs believe that high ethical standards and integrity are exceptionally important to long-term success. For example, a study of 128 presidents/founders attending the Harvard Business School's Owner/President Management program were asked to name the most critical concepts, skills, and know-how for success at their companies at the time and what they would be in five years. Seventy-two percent stated that high ethical standards were the single most important factor in long-term success. A study of 1,700 MBA students from the U.S., Canada, and the U.K. by the Aspen Institute found that MBA students are concerned that their schools are not doing enough to prepare them for ethical dilemmas they may face in the business world.¹ Their concern and awareness is not surprising given the recent spate of corporate scandals. Ethical lapses like those of executives at Ravelston Corporation and Hollinger International, for example, erode the confidence in business activity at all levels. It should also be noted that business students have a marked propensity to cheat. In a study of 5,331 students in the U.S. and Canada, 56 percent of MBA students indicated that they had cheated in the past year.² It has been reported that 73 percent of university students admitted to "serious cheating incidents" on