Entrepreneurship

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Lecture 39

Beyond Founders and Founder-Families – Part 1

Hi Friends, Welcome to the Course on Entrepreneurship. Over the past several sessions we have considered various aspects of entrepreneurship, especially in terms of how to set up an entrepreneurial firm, the motivations, the inspirations, the hurdles, the opportunities and various other aspects of development of an enterprise. We have also looked at how technology could be a great enabler for development of entrepreneurial enterprise.

In this session, we will swerve a bit and focus on the leadership essentials related to managing entrepreneurial firms. We have considered in the past sessions that the management and lead, leadership of entrepreneurial firms tends to be in a class of its own. At one level it is marked by a significant level of passion, commitment and innovation. At another level it is marked by some amount of disorderliness, multitasking, and wanting to do things by the fly.

In this session, we will look at entrepreneurial enterprises which have moved along and have become mainstream companies. By mainstream companies, I mean companies which are in a business model that is under execution where the products have been improved and the products are in commercialization stage and at various levels and some may have had growth and some may have had growth along with profitability.

So, we define mainstream companies as those entrepreneurial firms which have got reasonably successful business model. They have achieved a certain level of turnover and some of them would have achieved a certain level of profitability as well.

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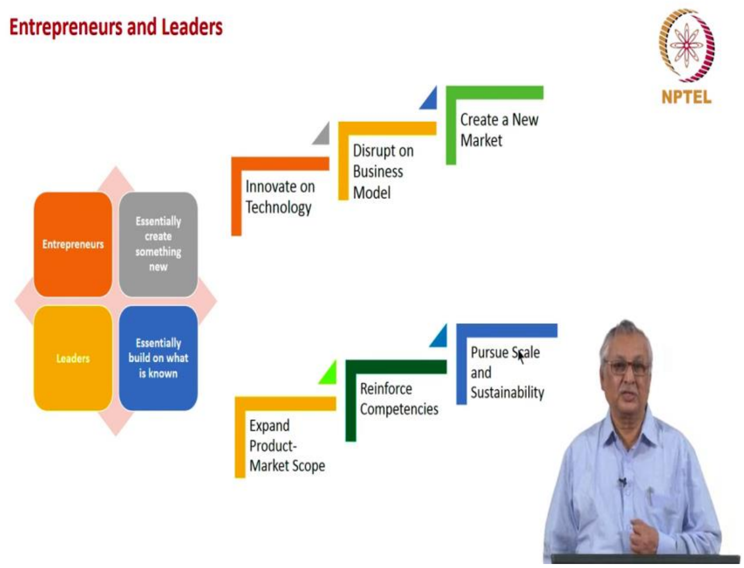

Now in this session, we will look at entrepreneurs who have been founders, who have led those firms and when and how they should transition to professional leaders. In the past sessions we have discussed some of these aspects in a kind of tertiary manner. We said that, there would be a time when entrepreneurs could probably hand over the reins to professional leaders and move on to do things for which they are best ordained.

But in this session, we will focus very strongly on entrepreneurs moving in a deliberate manner to give space to professional leaders so that their firms can grow and the issues related there too. And while doing so, we will also try to distinguish between the founders who are not belonging to any business families and founders who have got certain level of entrepreneurial family backing. So, we refer them as founders, and those who have got family backing as family founders.

Now when we talk about entrepreneurs and leaders, we may say that both the classes belong to certain leadership class, both have to lead. Entrepreneurs essentially create something new while essentially build on something that is already known. Entrepreneurs innovate on technology; they disrupt a business model and they create a new market.

We have talked about these aspects earlier. We talked, for example, on ride hailing services. The business of taxis has always been there. But they have disrupted the business model by aggregating the demand and supply through digital applications which is an innovation on technology. As a result, they have created not only a new market, perhaps a new industry as well. So that is how entrepreneurs lead their businesses.

On the other hand, professional leaders, they expand the product market scope, they reinforce the competencies which an organization has, and they pursue scale and sustainability. One of the hallmarks of professional leaders is that they tend to avoid what is not profitable. Even if it is not profitable in the first year, their emphasis will be on gaining profitability as soon as possible.

On the other hand, entrepreneurs pursue typically scale and, with or without profit. Even if there is no profit, they would think that once they occupy the market space, pricing power will come to the entrepreneurial firms and then profitability will also follow. These essentially are the differences between entrepreneur leaders and professional leaders.

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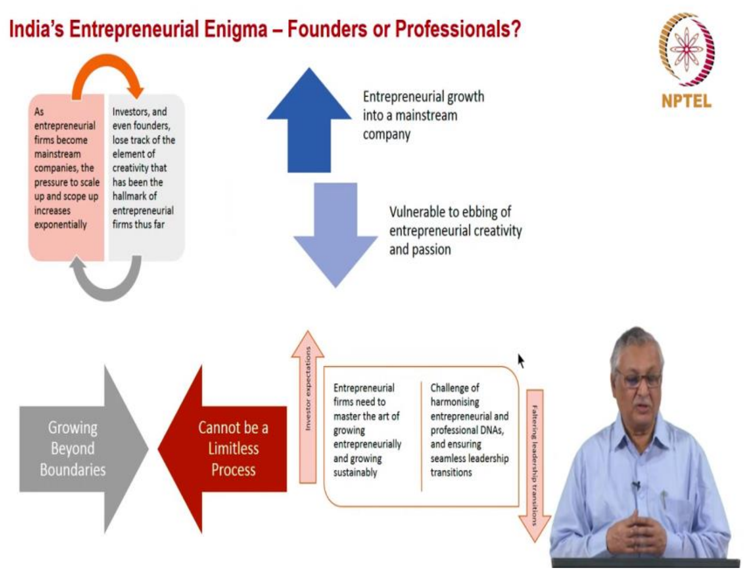

Now when we talk about entrepreneurship, there is an enigma. The enigma is how long the founders should be at the helm and when they should induct professionals. The motivations for this question are fourfold. First, as entrepreneurial companies become mainstream companies, the pressure to scale up and scope up would only increase. We have seen in the earlier sessions that investments that flow into the start-up firms have their own expectations.

The investors have their own expectations. While they are very generous with the kind of seed funding as well as angel funding and subsequent venture capital funding, they are also very demanding in terms of the scale up and scope up that the start-ups have to do. In this process of an entrepreneurial firm becoming a mainstream firm, somewhere along the route people miss the spark of creativity that has created the entrepreneurial firm, which has been the hallmark of entrepreneurial, of a typical entrepreneurial firm.

So, when we look at the growth of an entrepreneurial firm on the upside, a good entrepreneurial firm becomes a mainstream company sooner or later. But at the same time, it is also vulnerable to the ebbing of entrepreneurial creativity and passion as a result. Now, we have to appreciate as academicians and students and the entrepreneurs themselves have to appreciate as practitioners and creators of businesses' wealth, that growing beyond boundaries appears feasible at one point of time, but it cannot also be a limitless process given the boundaries that a particular industry may have.

Even if they have created new industries based on completely new technologies and new disruptive business models, that creates an industry and that industry will have its own limits and boundaries. Therefore, there is an aspiration to grow beyond boundaries, but at the same time, there is a kind of limit in terms of what the process of growth could be. Now the entrepreneurial firms have to balance the entrepreneurial growth aspiration with the sustainability requirement.

So, entrepreneurial firms need to master the art of growing entrepreneurially, while also growing sustainably. Therefore, there is a need to harmonize two DNAs. In the previous slide, we have considered that there is a difference between an entrepreneurial DNA and a professional DNA. Typically, a professional leader does not wish to take up a particular growth path unless it shows also the path to profitability. Whereas an entrepreneurial leader would nevertheless travel along the path as long as he or she believes that eventually he or she will conquer the entire market space and therefore have profitability at that point of time.

Now in the leadership situation, we have the challenge of harmonizing the entrepreneurial as well as the professional DNAs so that we have seamless leadership transition if there were to be one. So, we have to balance the investor expectations which will keep scaling up. We also have to look at the faltering leadership transitions that could happen if we do not understand the leadership essentials related to this leadership transition.

And our session is focused on the leadership essentials related to founders growing their firms, the challenges and advantages of having co-founders and the challenges of founders and co-founders yielding space to the professional leaders and the roles and responsibilities which the professional leaders themselves have in managing these transitions.

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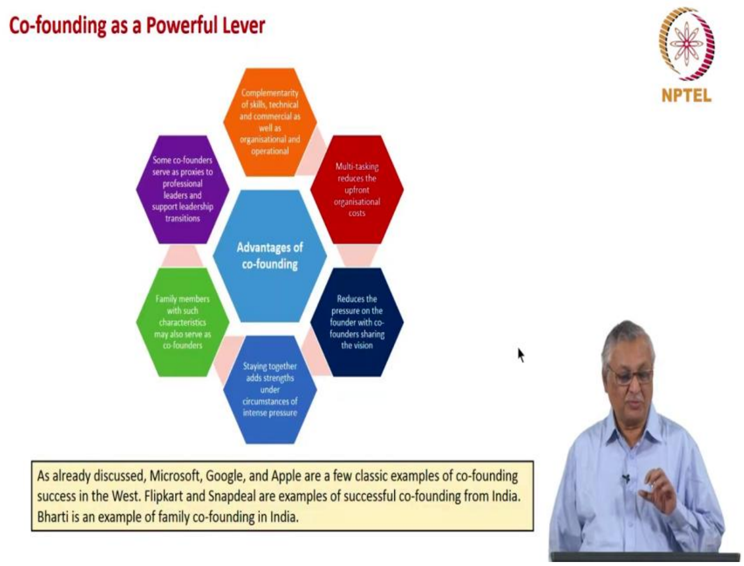

When we talk about founding, we have considered in the previous sessions that typically most entrepreneurial firms are co-founded. Very rarely, there are singularly founded companies. We have considered example of Google, Apple, Microsoft, Hewlett Packard, you name it, we have that all the start-up firms almost have been co-founded by two or more people.

Why a co-founding is a powerful lever. First, it provides the complementarity of skills, technical and commercial, as well as organizational and operational. So, there is an ability to cater to diverse needs of the entrepreneurial firm. Secondly, because people are doing multi-tasking it reduces the upfront operational costs. It also reduces the pressure on the founder. If one were to imagine that the entire start-up firm has to be established, scaled up and managed by a singular founder, one can imagine the pressure that the founder would have.

On the other hand, having two or more co-founders definitely reduces the pressure on the intellect as well as on the emotion of the founder. And also, when the co-founders share the vision, the common thread of developmental passion that accrues to the entrepreneurial firm would be significantly higher. We also considered how common thread is a very important aspect of boosting the entrepreneurial power of an organization.

Then staying together as co-founders adds immense strength to the entrepreneurial firm, because an entrepreneurial firm typically goes through vicissitudes as it tries to develop its product and as it tries to scale up its products. So, staying together under harsh and difficult terrain of entrepreneurship increases the organizational strength.

At times family members also serve as co-founders it has been discussed in our earlier sessions that Kent was an example where the family members work together and then they promoted Kent. Similarly, even Bharti, which is a giant today, Airtel, it has been co-founded by people. So, some co-founders serve as proxies to professional leaders. This is very important.

When we have co-founders, all co-founders may not have the same level of entrepreneurial DNA or the same type of entrepreneurial DNA as the founder has. Some people may have been trained professionally in a significantly different manner, and therefore some co-founders could even serve as proxies to professional leaders and they themselves could help in leadership transition.

There may not therefore be in a situation of having multiple co-founders, there may not be a situation of all the co-founders leaving at one go and the firm searching for leaders to succeed. If the co-founders have got the professional DNA in them, possibly they could lead to a more progressive and more systematic transition to professional leadership.

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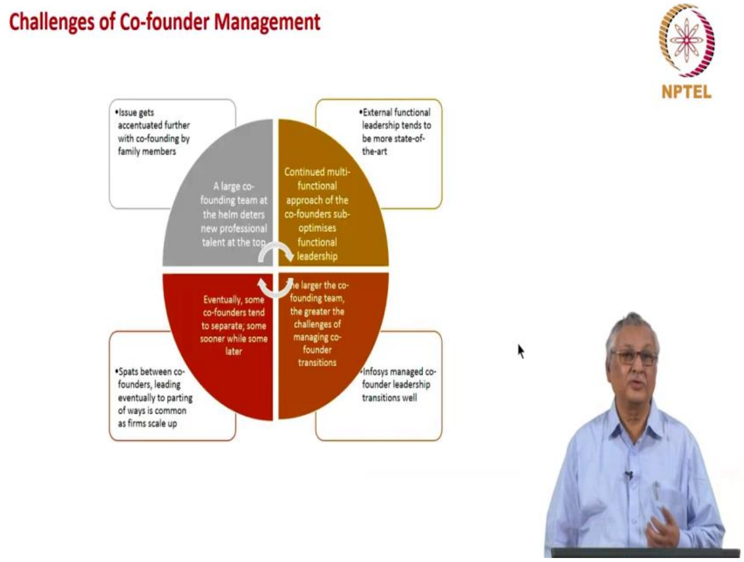

But having co-founders is a good thing that certainly it is also a kind of challenging aspect. There are four aspects of co-founder of management that are challenging. One, having a large co-founding team at the helm means that professional leaders find it that much more time consuming to reach positions of leadership and having many co-founders at the helm also deters outside talent to come in because they know that the co-founders are likely to take the highest possible leadership bench. That is one factor. And it gets even further accentuated when the co-founders are family members.

Second, the continued multi-faceted functional management approach of co-founders sub-optimizes functional leadership. An entrepreneurial firm by definition grows based on multi-tasking of the co-founders. But when co-founders exist in the entrepreneurial firm at the higher at glance, their continuing multi-functional approach ensures or makes the functional leadership difficult to grow.

So external functional leadership tends to be more state-of-the-art than co-founder driven functional leadership, because people have, in the past, worked on three, four functions simultaneously, probably they have not mastered any of the functions, although they have been jacks of all the functions in terms of the ability to move along.

Therefore, when you get external functional leadership and they find that the co-founders are still there having their own functional approaches to managing the business, there could be some level of conflict and the need to manage the stress would be all the more. The larger the co-founding team, the greater would be the challenges of managing co-founder transitions.

Forget about transiting from the founder to the professional leader, transiting from one co-founder to another co-founder itself could be a challenge. That does not mean that the companies cannot do that. The Infosys did manage the co-founder transitions exceedingly well. Probably that is also related to the fact that some of the professional leadership qualities have already been ingrained in the co-founders and they could perform the new roles with aplomb.

Eventually some co-founders do separate, it has happened in the examples which we have discussed like Microsoft, where Paul Allen departed. Then we had the examples of Apple, we had the examples of Hewlett-Packard, where there have been separations, but the difficult portion is when co-founders have spats or differences of opinion.

And if that leads to parting of ways as the firm scale up there could be some kind of turbulence in the pathways of the entrepreneurial firms. So, while co-founders are essential, co-founders are desirable for the growth of the company in different directions, the presence of co-founders themselves requires a higher order of management amongst themselves and between the founder and the co-founders.

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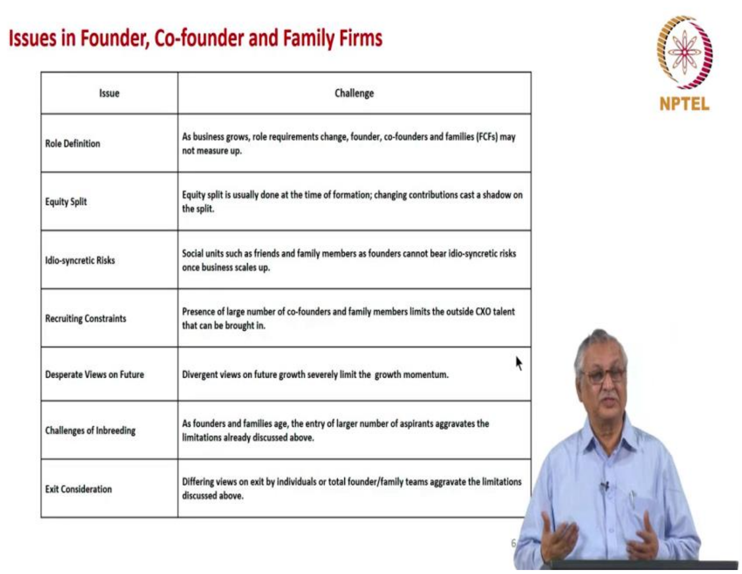

Now, let us define in little more detail the issues in founder, co-founder and family firms. The first issue is one of role definition. As business grows, role requirements change. The same way of management by the founders and co-founders would not gel in the new expanded business scope. So how do we define the roles and responsibilities of co-founders as businesses scale up. The second is the equity split. When the company starts off, most co-founders could have equal equity arrangement.

But as a firm scales up, it would be evident to the co-founders themselves as also to the external investors that the balance of contribution has moved away from the original equal understanding. So how do we do this equity split? How do we do the management of the proceeds arising out of the intellectual risk capital they have invested in the company in return for the equity provision? And how do these changing contributions cast a shadow on the relative commitments and diligence to the entrepreneurial firm.

Then we have got idiosyncratic risks mostly in respect of family run companies, but also in respect of certain entrepreneurial firms, it is possible for certain co-founders to come with their own idiosyncratic approaches as to how to conduct business. It could be like a commitment to cost reduction or a commitment to continued innovation. People tend to take binary positions and how these kinds of binary positions are difficult to support when we have mainstream operations going. So how do we handle these idiosyncratic risks as a company scales up.

The fourth challenge is the recruiting constraints. As I have had already discussed, presence of large number of co-founders and family members limits the ability of the entrepreneurial firm to induct fresh talent. And if they do induct fresh talent, possibly the talent is not the level of talent which is aspiring to get into CXO post at the earliest, which again, sub-optimizes the potential of bringing in the external talent.

Then, desperate views on future. While, all the co-founders may start-off with the shared agenda and shared vision and an agreed strategy as a company reaches an epitome of functioning, there would be different voices and different perceptions on how the company should pursue the further growth plan. Therefore, there could be divergent views on future growth, which would severely limit the growth momentum.

The other challenge is the challenge of inbreeding. If all the positions in an entrepreneurial firm are occupied by, let us say, the classmates coming from the same curriculum and from the same institute or in respect of a family founder-led company if all the positions are taken by the family members, then there is a challenge of inbreeding, because the talent gets sub-optimized based on the institutional limitations in respect of the first example, and based on the family intellectual limitations in respect of the other example.

Even in the case of institutions, we all know that institutions would ideally require that a certain portion or a significant portion of faculty recruitment is from outside institutions that helps avoid inbreeding. Wherein, there is a perpetuity of the same line of intellectual thought that gets manifested and that gets institutionalized in a particular institution. The same applies to the entrepreneurial organizations also.

If people who have shared the same level of intellectual approach, the same style of functioning continued to bring in their own approaches and institutionalize them, there is that much of hindrance to bring in state-of-the-art talent from outside. Then the final challenge or the issue is the exit consideration.

How does the market take when in a mainstream company some of the co-founders exit? How should that be positioned? Is it a natural phenomenon or is it an unnatural phenomenon? Does this phenomenon require elaboration or it is simply a natural part of growing up? So, these are the issues a company would have in terms of founder, co-founder and family firms.

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I would like to talk at this point of time about the great example of Infosys, how it has managed its co-founder advantage and how it has managed the transitions. I would turn this thesis as Infosys insight with lot of growth foresight. Infosys, as we know, was founded in 1981 with a very modest capital of 250 U.S. dollars by a team of passionate technocrats led by Mr. NR Narayana Murthy.

Over a period of time, Infosys became a pioneer in developing and leveraging Indian software talent to provide global software solutions. And again with this singular focus on its creation, which is a global delivery model of providing software solutions both onshore and offshore, and providing them on a 24 by 7 seamless basis, the company became a well knit, rapidly growing organization and it never had to look back once it achieved the success with its global delivery model.

Infosys got listed several years ago on Indian bourses National Stock Exchange as well as Bombay Stock Exchange and has also got listed in on U.S., New York Stock Exchange. Over time, it has become the bellwether of India's IT industry. Today it has a turnover of 12 billion dollar, market valuation of $47 billion and a global employee strength of 228,000 statistics as of March 31, 2019.

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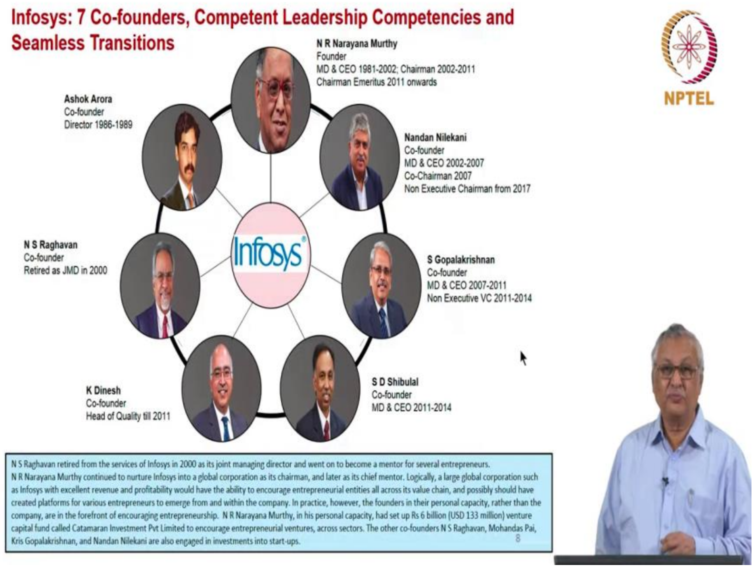

And this has become possible because the leadership bench at Infosys was very strong, very cohesive and very competent. The company was founded by 7 founders. They had competent leadership abilities and they had seamless transitions as the company scaled up. We had NR Narayana Murthy, the Founder or the lead Co-Founder. He was the MD and CEO from the time the company was set up until 2002.

He became the Chairman in 2002, and worked as Chairman in till 2011 and he became Chairman Emeritus from 2011 onwards. There have been occasions or requirements for him to come back into an executive role for a few months and that is not germane to this discussion. Then we had Nandan Nilekani, who was the Co-Founder. He was MD and CEO after Narayana Murthy handed down the baton to him and he was ably running the company until 2007.

He became the Co-Chairman in 2007 and Non-Executive Chairman he became from 2007 under certain turn of events. And we all know that after he laid down his position in Infosys, he became the Chief Executive of Unique Identification Authority, Aadhaar, of India and made immense contributions to this development of Aadhaar system in our country. After Nandan, S Gopalakrishnan, popularly called Kris Gopalakrishnan took over. He was also a Co-Founder. He was MD and CEO between 2007 and 2011 and became Non-Executive Vice Chairman between 2011 and 2014.

Thereafter, SD Shibulal, another Co-Founder took over and he worked as MD and CEO between 2011 and 2014. So, if you see these four leadership transitions after Mr. Narayana Murthy laid down office in 2002, I mean, laid down office of full time CEO position, the company managed itself exceedingly well through contributions by the co-founders at the helm.

We also have in the same corporate paradigm a few co-founders who found other pastures. Notably, K Dinesh, who worked as Head of Quality under different phases of the company. He moved on after 2011. NS Raghavan, who was Co-Founder, he retired as Joint Managing Director in the year 2000. Another Co-Founder, Ashok Arora, he moved on in 1989 itself after serving the company as Director between 1986 and 1989.

So, a few of the further details are mentioned here. It is also very interesting that even as these co-founders were responsible for entrepreneurially fired growth of Infosys, most of these co-founders have used their personal success and personal wealth to promote an entrepreneurship, rather than leveraging Infosys itself as a corporation to promote greater entrepreneurship that is a matter for a different discussion.

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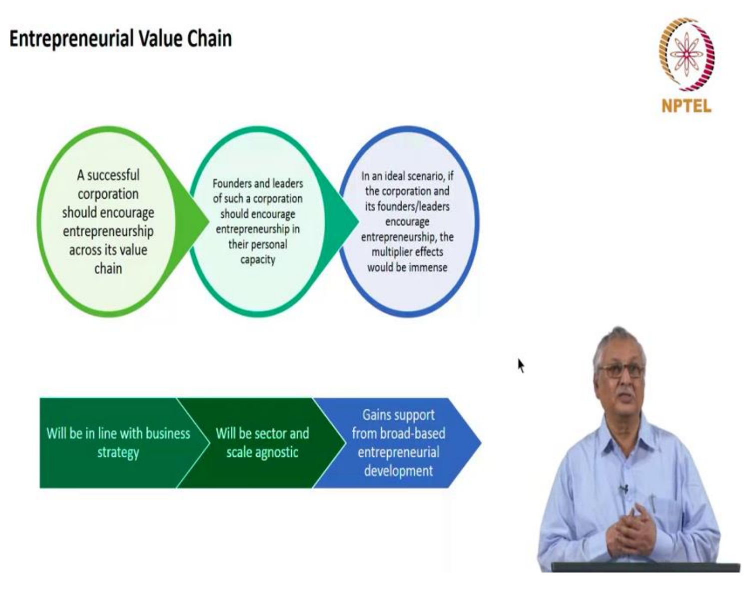

Now let us look at the entrepreneurial value chain in this context. One is managing an entrepreneurial firm. Second is the successful entrepreneurial value chain, a successful company could generate. In my opinion, I am sure you would also agree, a successful corporation should encourage entrepreneurship across its value chain.

It is a kind of ancillary development in the automotive parlance, but in terms of the information technology value chain, for example, there could be several opportunities to develop mini products, mini applications and ensure that the newer languages are developed or improvements to the existing languages are developed. So, there could be many ways in which the entrepreneurial value chain of a software company or for that matter any other company can be expanded.

Second, founders and leaders of such a corporation should encourage entrepreneurship in their personal capacity and we have seen how the founders of, co-founders of Infosys successfully did such a development. In an ideal scenario, if the corporation does this kind of entrepreneurial diversification, and also the leaders in their personal capacity provide momentum for that, the potential for entrepreneurial diversification, diffusion of entrepreneurial talent and the generation of entrepreneurial spirit in the country would be immense.

So, when a successful corporation does entrepreneurial development by itself, it would be broadly in line with business strategy, it will be broadly in line with the principle value chain the company has. When the founders and leaders of such a corporation encourage in their individual personal capacity, entrepreneurial development, in fact, it could be sector and scale agnostic.

And when, in this ideal scenario of both corporation and leaders promoting entrepreneurial development, you would really find a very broad based entrepreneurial development, not only within the sector, but across sectors. So, this is the whole idea of looking at entrepreneurs developing more entrepreneurs, entrepreneurial corporations developing more entrepreneurial companies.

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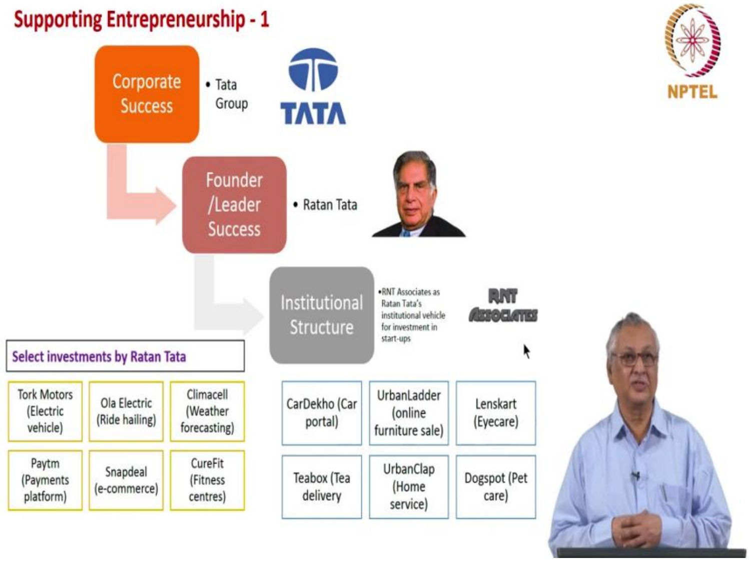

We will look at a few examples. We have got Tata Group, an immensely successful, immensely trustworthy and immensely technically savvy corporate group. The Tata Group is one of the most successful business conglomerates in India. And as its leader for a long period of time Mr. Ratan Tata also enjoyed great success.

Now post his retirement, he has set up RNT Associates as the institutional vehicle for investment in start-ups. I have listed here a few investments by Ratan Tata in a number of start-up domains and number of start-up companies. So, they range from pet care to electric vehicle ride handling, they range from weather forecasting to fitness centers. So, the association of such a successful leader itself is considered a great investment by many of the start-up companies and they see this investment by a mock investor like Ratan Tata as an important input to their growth journey.

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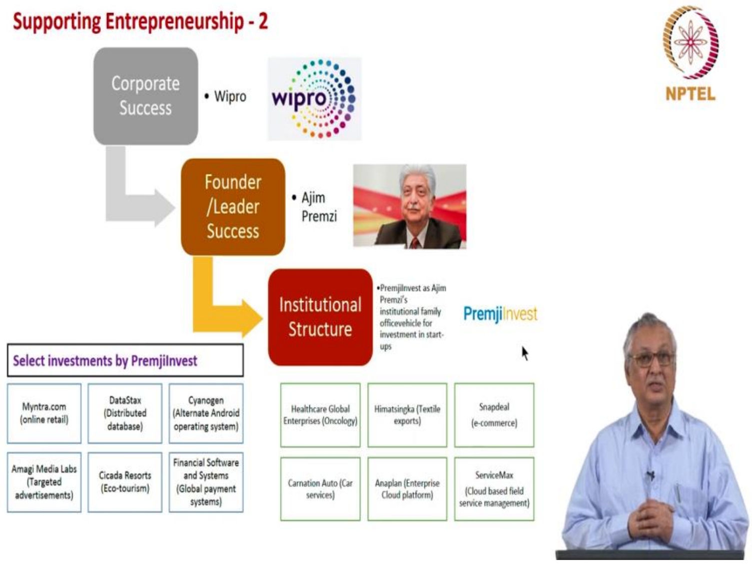

We can also look at Azim Premji. He has PremjiInvest, which has invested in several start-up companies, but it also invests in certain listed companies. Unlike RNT associates, which is more focused on tech-based start-ups and primarily unlisted entrepreneurial entities, PremjiInvest follows an investment strategy of having both the entrepreneurial firms as well as listed companies in its product portfolio.

Many of the investments are in the healthcare sector, in the IT sector. But at the same time, there are investments that have been made in regular services such as automobile services and ecotourism. So, these are the two examples of industry stalwarts channeling their success led wealth into supporting entrepreneurial development.

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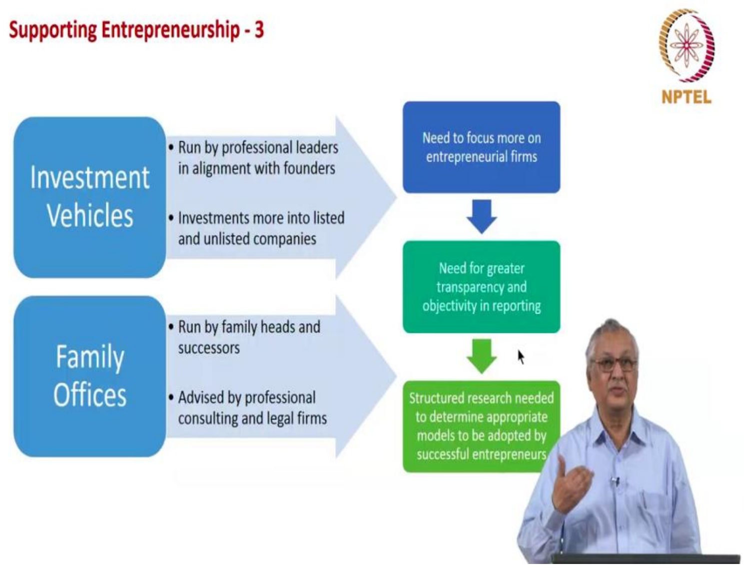

Now there are two ways in which the founders promote entrepreneurial companies. One is through investment vehicles. These are run by professional leaders in alignment with the founders and investments move into listed and unlisted companies. We, they also have family offices which are run by family heads and their successors and these are advised essentially by professional consulting and legal firms.

But in this journey of investment vehicles as well as family offices set up by successful entrepreneurs, I would think that there is a need to focus more on entrepreneurial firms than on listed companies, while listed company investments are necessary to expand the corpus of investment a judicious mix between entrepreneurial and listed firms is required. Secondly, there must be greater transparency and objectivity in reporting how the investments have fared, whether they have been successful or not successful.

In respect of, let us say, mutual funds, we have substantial clarity on how the various investments fare and what are the mark to losses or profits they have as they proceed. But in respect of the investments by family offices or investment vehicles, we would not have that level of clarity in reporting. The clarity in reporting would be very helpful for appropriate entrepreneurial firms to feel emboldened to make the pitch to those entrepreneurial support vehicles.

Third important aspect is that, we need structured research. How this type of investment is really helping the entrepreneurial firms. How the entrepreneurial models adopted by the entrepreneurs themselves are not only financially stabilized and empowered, but also coached and mentored by these vehicles which are generated by people who have been very successful at entrepreneurship itself. So, there is a synergy of both the financial strength and entrepreneurial strength that comes to the investments made in the entrepreneurial companies through family offices or investment vehicles. So, there is need for further research in this subject.