

THE ROLE AND INFLUENCE OF FIRM FOUNDERS

Teresa NELSON

Summary

The founder role is irrefutably essential to a well functioning capitalist economy. The founding of new ventures fuels competition, delivers new products and services to the marketplace, and even creates entirely new categories of industry. In this article the key governance role of founder is conceptualized and questions of how, why, and when founders participate and successfully influence the firms that they found are addressed. In addition, recent academic results on the persistent influence of founder CEOs on governance and ownership arrangements, and stock valuation, are presented.

Introduction

Every firm exists because some founding person or group of persons made the decision to establish a firm and then acted on that decision. Founders, as firm creators, are the initial architects of the organization's structure and strategy. In this role they hold a vision of what they want the organization to be and do, and they are generally unconstrained by previous ways of doing things.

To build a better understanding of this key organizational role it is important to develop a fuller conceptualization of how, when, and why founders are involved in the firms they establish. From this conceptual grounding the persistence of founder influence on the firm post-start-up can be considered. Obviously founders are keys early in the existence of the firm, but does their influence persist? And how is it felt?

The founder role is fundamental to a working capitalist economy. Evidence abounds in the practitioner literature about the role and influence of founders on their firms (current examples of leading founder CEOs in the U.S. include: Bill Gates, Michael Dell, Lillian Vernon, Ralph Lauren, and Herb Kelleher, to name a few). Considering and therefore making sense of the founder role at firm inception and beyond then delivers theoretical and practical value to business people and academics alike.

Survey of Knowledge

Many domain areas in the management literature acknowledge the founder role, yet there is little direct and comprehensive discussion. In organizational theory the focus is on the firm and population level; the founder's role is taken for granted or ignored. In entrepreneurship the roles of founder and entrepreneur are not distinguished though we know the roles, while often

overlapping, are not the same (i.e., an entrepreneur may not have founded the firm he/she leads). Research on top management teams, and more generally on governance relationships, examines the influence of upper echelon members on the firm and the system of management and ownership at the pinnacle of the organization, but the focus is on large, established corporations often long removed from the founding period.

Therefore, while founders are acknowledged as the directors of strategy and human resource patterns of the new firm, an understanding of their role and their contribution to the governance structures of the firms they establish requires some additional reflection.

Founder

As with the terms ‘organization’ and ‘leader’, ‘founder’ is a common word in the English language, yet its semantics are complex. A working definition of the word is drawn from Webster’s Dictionary: “founders set-up or establish.” Three fundamental issues concerning the meaning and definition of founder are: a) the relationship between organizational founding and founders, b) the key characteristics of founders, and c) the founder role as socially constructed.

The relationship between organizational founding and founders

Operationalization of the concept of founder requires a definition of firm founding. Hannan and Freeman state, “The first step is deciding when an organization begins” (1989:147) and they define founding as a process which involves a series of steps: initiation, resource mobilization, legal establishment, social organization, and operational start-up undertaken by an individual or group of individuals. This process may take months or years.

The key characteristics of founders

A logical conceptualization of ‘founder’ is then “those individuals involved in actualizing the steps of organizational founding.” Clearly, some threshold level of activity, in terms of the amount and/or the kind of activity, distinguishes the founder(s) from others who participate in the new venture process. Single or multiple founders per organization are possible. The steps of organizational founding will involve tasks that are tangible and intangible, practical and symbolic. Completing the founding steps will take time as some are sequential, and some require the founders to interact with outside individuals and organizations. Finally, there is a beginning and an end to the founding process. Once the organization is operational, founding is complete.

From these points, it is possible to formulate a set of connotations for the founder construct: a) founders organize and take initiative in the organizational founding process; b) founders are likely to work on important organizing tasks; c) the initiation step is particularly important because it is likely to establish ownership of the process, define its scale and scope, and imprint an organizational pattern; d) founders’ efforts are likely to persist over time and contribute to completion of the founding event; e) an organization may have one or more founders; and f) for a founder to be declared, a company must become operational.

The founder role as socially constructed

While these connotations moving us toward a definition of ‘founder’ may be useful, of course they are not binding. A founder’s identity is not established unequivocally by the taking of any particular action, or any particular set of actions, as regards organizational founding. Founder identity is not defined by law or regulation as other roles are (e.g., president is legally required

for incorporation, major owner is legally defined under securities regulation). Rather, the role of founder is self-designated or other-designated. The meaning of the role is socially constructed through thought, conversation, and linguistic interchange and negotiation among involved parties. For example, a person who arranges the capital necessary for an organizational start-up may be a founder. However, if that person is hired by another person to do that work, and it is not her initiative that led to the task, then she may or may not be a founder. The decision will likely depend on the meaning and requirements of founding established within the founding group. Likewise, the bank executive who approves the loan as part of the capital package would generally not be considered a founder, unless perhaps he serves on the new company's board of directors and played a role in designing the fundraising strategy, to include a loan from his bank.

Founders and Their Continuing Role and Influence Post-Start-Up

Though the founder role ends at firm operationalization (within the logical argument presented above), the *influence* of the founder may persist. A means to boost this persistence involves assumption by the founder of additional organizational roles pre- and post-start-up. Note that the founder role itself does not confer structural authority or financial return. Further, being a founder does not necessarily or logically associate with any other particular role post-founding. However, given the founder's responsibility (sole or joint) as initial organizational architect, the roles he/she assumes are likely to be in the upper echelon of the organization, for example, as owner, management executive or board director.

Founders may remain associated with their firms for a lifetime, though research to date has discussed founders primarily in the context of business start-ups. There has been some discussion on whether founders are associated with an entrepreneurial management style that may be incompatible with the growing or more established firm. However, anecdotal support exists for the long-term involvement and contribution of founders in well-established organizations. These leaders may change their style to accommodate the growing organization or use their start-up experience to advantage or disadvantage later in the firm's life.

All founders will exit, whether early or late in the life of the firm, unless the organization fails first. Multiple founders may leave together, or some may leave earlier than others. Founders depart from management leadership positions willingly and unwillingly. They may die, or be fired or displaced into subordinate positions by owners displeased with their performance. In other cases they may relinquish management and/or equity stakes voluntarily. When the population of post-start-up firms is considered, some will have active founders and others will not. For the latter group, a great variety of configurations of founders in the firm may exist: there will be differing numbers of original and remaining founders, founders will fill different roles, and they will make varying contributions to the firm's continuation and success.

Specific mechanisms for founder influence post-start-up may be additive or interactive. The ways founders influence the continuing firm include:

- *Founder as focal point.* When founders are visible in the organization they may serve as a focal point for other decision-makers because of their knowledge, experience, and organizational stature.
- *Founder imprinting.* The founder sets the initial structure, strategy, and culture of the organization through early decisions, including many that occur pre-start-up.

- *Founder psychological commitment.* Founders derive more than profits from the ventures they begin. Their commitment to the continuation and success of the firm ties to ego and self-actualization and may carry them to higher levels of contribution, compared to other stakeholders of the firm.

- *Founder ownership control.* Founders often are start-up owners. Extraordinary power accrues to owners who hold large absolute or relative stakes of ownership.

- *Founder structural authority.* The founder who holds the CEO or another top management position holds authority and responsibility for high-level decision-making. The structure bridging owners and managers, i.e., the board of directors, holds additional positions of individual and joint command, especially the officers of the board.

- *Founder tenure.* Active founders, *ipso facto*, will be the longest tenured members of the organization. Tenure results in firm and industry level experience that builds valuable knowledge and practice for the firm and it allows for the development of information sources, relationships, and problem-solving routines.

Founder in the Context of the Working Organization

One way to conceptualize the founder's relationship with the organization and its stakeholders over time is to consider the founder as 100% owner/manager of the firm at the initial point in the founding process. Sometime in an organization's early life founders engage social agents, be they investors, employees, suppliers, or the government. Within the framework of the organization, these parties exchange inducements and contributions to enhance the firm's survival and growth, and perhaps prosperity. Examples include: a founder exchanges x% of ownership for capital to fund operations; founders hire additional workers and relinquish to them certain authority and decision-making power; certain officers meeting prescribed requirements are appointed to the firm by the founders to incorporate with the state, etc. Within this logic, founders balance the value of their immediate, personal ownership and management control of the organization with its survival and growth needs, taking into account the immediate and future benefits derived from the exchange. Within some parameters, founders likely express their preferences on these exchanges, and the organization is affected as a result. For example, founders may decide against venture capital funding or public stock ownership so as to retain more ownership and management authority. This may result in the firm growing at a slower pace, and perhaps survival chances will be influenced.

The Persistence of Founder Influence: Research on Founders and Firms at Initial Public Offering (Nelson, 2003)

New research has delivered findings on the persistence of founder influence on growing firms. An aggressive survey data collection process procured data on 84% of the independent firms conducting an Initial Public Offering (IPO) on major stock exchanges in the U.S. in 1991 (Nelson, 2003). The IPO is an organizational milestone; a voluntary and strategic act that changes the governance and ownership structure of the firm, usually permanently (while reverse IPOs, or buy-outs, are possible, they are uncommon). This setting is useful for considering the persistence of founder influence because IPO requires firms to reconcile their governance and

ownership structures to government, investor, and stock exchange rules and norms, thereby providing a reasonable basis for inter-firm comparison.

Results show (Nelson, 2003) that founders are active in their firms at this important stage of organizational life; 65% of the firms studied had founder CEOs. While founder CEO presence and firm age were negatively correlated, founder CEOs were identified in IPO firms more than 20 years old. Challenging and enriching the common perception that IPO firms are largely in high technology sectors, the analysis found that 48% of the firms existed in industry sectors other than high technology. Founder CEOs were identified in every defined industry group, although the mean presence of founder CEOs is highest in manufacturing and in the specific segments of electronics and computer manufacturing. Founders are least likely to be CEOs in general services and pharmaceuticals/biotechnology. Founders are nearly equally represented as CEOs across quartiles representing total firm assets.

Founder-led firms were also dependably associated with particular governance features and favorable investor reaction across industry, firm size, and firm age parameters. Specifically, the findings (Nelson, 2003) show that firms with founder CEOs have a higher proportion of inside board directors. These firms also release a lower percentage of firm share ownership to the public at IPO. CEOs who are founders are more likely to personally own a greater percentage of the company at IPO and higher ownership levels by founder(s) correlate with a founder holding the CEO role. All of these results support the proposition of a “founder centric” governance structure: control is more tightly held and exercised in founder-led firms. Regarding duality of CEO and Board Chair roles, founder-led firms are distinct in not acting like average U.S. firms: founders CEO are less likely to serve simultaneously as board chairs. Founder CEOs may find that as their firms grow they must barter some control for outside resources and releasing the Board Chair role may be a consistent outcome of the negotiation.

In relation to investor reaction to the presence and influence of founders in IPO firms, this research found that founder-led firms collect a higher premium of stock price over book value at IPO. Investors value founder CEO firms at a higher level than non-founder CEO firms, as compared to accounting value. As these firms are often growing, some at very rapid rates during this organizational stage, the symbolic value, psychological commitment, ownership, structural authority, and tenure of founders may directly indicate and indirectly proxy the value of a firm’s management to potential investors.

Conclusion and Recommendations

The level and success of entrepreneurial activity is often viewed as a prime indicator of economic growth and stability for leading and emerging economies. For this reason a well rounded understanding of the role of firm founder(s) within the governance structure of the firm is a significant topic for business academics, government researchers, and business people alike.

Distinguishing the founder role and understanding how founders may hold extraordinary influence as governance leaders helps us to better understand internal organizational relations (e.g., the sources of power and influence) as well as external effects (e.g., the evaluation of firm value by outside stakeholders). Potential mechanisms of a founder’s organizational influence including focal point role, psychological commitment, ownership and management position, and tenure may help the firm survive and thrive. Underlying these mechanisms is the potential value of unambiguous and directed leadership brought by founders to the firms they establish. This

style of leadership may be particularly valuable for firms that confront change conditions at the firm and industry level.

Recent research (Nelson, 2003) that explores the persistence of founder influence complements recent findings on organizational imprinting (Baron, Hannan, & Burton, 2001) suggesting that particular firm-level arrangements of management and ownership correlate with the continued presence of the founder in a leading organizational role post-start-up. Overall, founders negotiate the dissipation of their governance and ownership control as part of the process of ensuring the organization's survival (and the actualization of their own preferences), then when they remain with the firm over time, the organizational structures reflect their influence.

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