Frontiers of Entrepreneurship Research

Volume 37 | Issue 8
CHAPTER VIII. ORGANIZATION: TEAM & GOVERNANCE

Article 12

6-10-2017

PROTECTING WHAT MATTERS? WHEN DO FOUNDERS SIGN DYNAMIC EQUITY AGREEMENTS? (INTERACTIVE PAPER)

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INTERACTIVE PAPER

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Principal topic

One of the earliest decisions founders face is how to split the equity in their team. This equity splitting process tends to be fraught with tension as it implies assessing each founder's past and future contributions (Wasserman, 2012). Therefore, founders are often given the advice to avoid static equity agreements and instead include dynamic provisions such as vesting schedules and buy-out terms (Hellmann and Thiele, 2015; Wasserman, 2012). Whereas recent studies on founder equity agreements have examined determinants and consequences of founders' equity distribution (e.g., Breugst et al., 2015, Hellman and Wasserman, 2016), there is a lack of research on founders' choice to include dynamic provisions in such agreements.

Method/Model

This study draws on models of trustworthiness and addresses the question whether trust within the founding team influences the use of buyout terms. Trust as the willingness to be vulnerable to others (Rousseau et al., 1998) has been found to increase risk taking in relationships (Mayer at al., 1995). In line with this argument, we suggest that founding teams with higher levels of trust will be less likely to rely on buyout terms in their equity agreements. Specifically, we argue that founding teams composed of higher-quality and more committed founders will generate beliefs towards each other that they are competent and will act with integrity. Therefore, they will be less likely to include buyout terms. Increased familiarity among co-founders should increase the belief that the founders will act in the company's best interest and hence also reduce the likelihood of including buyout terms. Extending the trust literature, we do, however, challenge the assumption that trust will *always* increase risk-taking. Specifically, we argue that not all founding teams may be equally aware of the fact that by not including buyout terms they make themselves vulnerable. Thus, under conditions of less knowledge about the existence of such terms, we expect trust to have a weaker impact on founders' use of buyout terms.

Implications

This study contributes to the entrepreneurship literature by addressing antecedents of founders' buyout terms. Using trust literature, our model shows how the presence of buyout terms varies based on the founding team's attributes.

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