



**HOW TO PICK A
CO-FOUNDER!**

HOW TO PICK A CO-FOUNDER

BY VENTURE HACKS

Copyright © 2009 by Venture Hacks Inc.
VENTUREHACKS.COM

All rights reserved. No part of this book may be reproduced in any form or by any electronic or mechanical means, including information storage and retrieval systems, without permission in writing from Venture Hacks, except for brief excerpts in reviews or analysis. A number of passages are reproduced in this book, with the permission of their copyright-holders.

Formatting inspired by Edward Tufte and 37signals.

First edition

Thanks for buying this interview.

Please don't make copies.

You can buy it at <http://venturehacks.com>.

Yo!



CONTENTS

Disclaimer	6
Introduction	7
How to pick a co-founder	8
1. <i>How many co-founders?</i>	9
2. <i>How do you create a history together?</i>	15
3. <i>How should you divide up the company?</i>	17
4. <i>Who's the boss?</i>	19
5. <i>Do you even need a CEO?</i>	21
6. <i>What skills do you need on the founding team?</i>	23
7. <i>Why do you need aligned motivations?</i>	25
8. <i>Should I compromise on a co-founder?</i>	27
9. <i>Why should I partner with a nice guy?</i>	29
10. <i>How can I tell if the other guy is a good builder/seller?</i>	31

<i>11. How do I convince someone to partner with me?</i>	33
<i>12. What if my co-founder needs a salary?</i>	36
<i>13. Where do I find a co-founder?</i>	39
<i>14. How do I start a business with family?</i>	40
<i>15. How do I start a business with friends?</i>	41
<i>16. How many co-founders? (Redux)</i>	43
About the Authors	44

DISCLAIMER

This book provides information, not legal advice. Use it at your own risk.

Information is not the same as legal advice. Legal advice is the formal application of information to an individual's specific circumstances.

Although we strive to make our information accurate and useful, you should consult a lawyer before applying it to your particular situation.

We do not take responsibility for rashes, financial ruin, or any other misfortune that follows — either directly or indirectly — from applying the information in this book.

We are not lawyers. Get a lawyer.

INTRODUCTION

This is a transcript of an audio interview from Venture Hacks.

We've highlighted the salient points.

HOW TO PICK A CO-FOUNDER

Get good cofounders. You can't change who you are, at least not in a short time. And the idea doesn't matter to us as much as the people. So the best thing any individual can do is find good people to work with.

— PAUL GRAHAM

1. *How many co-founders?*

Nivi: This is Nivi from Venture Hacks.

Naval Ravikant: And Naval from Venture Hacks.

Nivi: We recently posted an article by Naval called "How to pick a co-founder." You probably checked it out. If you haven't, take a look.

We got a lot of questions based on the article, and I also have questions based on the article, so we're going to answer your questions. We're going to try to elaborate on what we wrote and try to give some more examples of some of the things we talked about.

So, the most common question we had was about two-founder companies. Is two founders really the only way to go? What are the pros and cons of two founders and other types of situations?

Here's some of the feedback we got:

Ram said, "As you point out, there are several advantages to having two co-founders, but I think your perception exaggerates the odds against single-founder companies. From this week's news,

AdMobs is a great example of a successful single-founder company.”

Gabor says, "Was Facebook really a one-founder company? Maybe I'm bad at my Facebook founding history, but it seems like there were multiple. It was one-founder in the sense that Mark Zuckerberg is both a builder and a seller, but I feel like there have to be more good examples of successful one, three, and four-founder companies. It seems like you guys dismiss anything other than two, too quickly.”

And then finally, Mark Essel says, "I don't see three to four being a problem with the right group. Certain projects lend themselves to two; others can really get powered up by three to four founders. Engineer-heavy startups are common now, so doubling or tripling your development team at the outset is incredible. It depends on what other responsibilities team members have as well. Many startups are grown while folks work their day jobs, or part time to survive.”

So, the first question is, are we dismissing anything but two-founder companies too quickly?

Naval: I would say that's not the case. Of course three-founder and one-founder companies can be successful, it's just that generally speaking, over mass statistics, if you look at many, many companies, especially the bigger ones, it's usually two founders that really matter.

Now, you may start with three founders or four founders, but very often the company tends to coalesce around two founders.

Or, you may start with just one founder, but that founder may have a very early and senior confidant who then ends up almost playing a founder role even though they join the company later. For example, if you look at Microsoft, Paul Allen stepped aside

after a certain point in time, and Steve Ballmer really became the guy who came in and was Bill Gates' co-founder.

So, I guess the important things to point out are that it is very, very important to have a strong, day-to-day partnership element when you are going through something as difficult as doing a startup. And whether that's with a co-founder or with a very early person who joins the company and fulfills that role, the titles matter less.

The issue with three or four-founder companies is not to say they can't succeed, it's just that it is much, much harder to divide up the roles in such a way that there isn't stepping on people's feet. It's much harder to find people of roughly equal caliber.

And then as a company progresses, in the much later stage, especially for a venture-backed company, you just end up with a lot less equity to go around. And you don't want to be in a situation where 10 years down the road – and by the way, it takes 10 years to build a truly great, huge primary franchise – after your company's gone public, you've raised lots of venture capital, you may find that all of the founders, because you had so many of them, own one, two or three percent of the company, each, and there's nobody, really, who can take charge of the company and be the CEO and just drive it through thick and thin.

That persistence, that drive that's necessary in a founder, is important to the health and success of a company, not only early on, but also much later in the game. And as a company gets older and older, it becomes less likely that a four or five person company can sustain the equity stakes required.

Lastly, I would say that any time you have three people in a room together working on something, you get politics. Then it starts mattering who says it, how they position it and whether they can get two to gang up on the third.

One of the nice things about a two-founder company is both have to agree – at least in a well-structured two-founder company.

Nivi: OK. You went into a bit of the pros and cons, so why don't we talk a little bit more about the pros and cons. Three to four founders: what are the pros and cons? Let's catalogue them.

Naval: Well, the pros are, obviously, many hands make light work. So, if you have three or four highly incented founders, early on, and they're motivated like founders, they're just going to accomplish a whole lot. That's probably the single biggest pro.

You also have a diversity of voices and opinions, which can work both ways. It can be great when you're brainstorming and problem solving; it can be really bad when you're trying to make decisions.

One of the early problems a three or four-founder company struggles with is who's on the board. Because a lot of control and authority derives from the board, every founder wants to be on the board.

And VCs don't like that. They know it's dysfunctional when you have four founders on the board because then they can't really talk about each other or who's doing a good job and who's not.

The CEO also ends up having very diluted authority, because now he not only has to just command the respect of one person, he has to play a little bit of politics and keep everybody happy. So it ends up being a difficult management situation.

Nivi: How about pros and cons of two people?

Naval: The pros are, obviously, that you just have to establish one solid partner relationship, there's a clean division of roles and responsibilities, and there are minimal politics.

The cons are, if those two can't get along the company is effectively dead. You have no room for error or failure. If the

people don't get along you're going to have massive clashing. You're going to have too much DNA and time burned up internally.

And you just don't have as many people to go around, so the two have to be extremely good at what they do, which is kind of why I made the "one builds and one sells" distinction, because although you can occasionally find the superstar who can build and sell, selling is a full-time job, building is a full-time job, so you might as well just pick the best on the planet at each.

Nivi: Right. And how about the one-founder case pros and cons?

Naval: I think it's an extremely difficult case. I would recommend the three or four-founder case over the one-founder case.

Nivi: Right.

Naval: Well, let's start with the pros. The pro is that you get to keep a lot of equity. [laughs]

The con is that you have to do all the work.

Another pro is that it is completely your vision. It's one person's monomaniacal vision, which sometimes can be great. I don't know the histories of these companies, necessarily, but it sure feels like Salesforce.com is a one-founder company, with Marc Benioff having the bully pulpit.

So, it can definitely be one person's vision and one person's drive, and so forth, but that person had better be really, really driven and really confident, because every startup goes through tough times, and you won't have a shoulder to cry on, not really. You won't have someone to pull you up.

You also won't have a diversity of opinions so you'd better be right and just able to sustain it. ***But now you've basically got a company that is just an extension of one person's personality, with all***

the ups and downs of that. I think the proper analogy might be trying to raise kids by yourself; sure it's possible, but it's a lot easier with two.

Nivi: *I would say, whether you have a two-person, three-person, or n-person team, where n is greater than one, if you have a functioning team, don't worry about everything that we've said too much because a functioning team – an effective, well-functioning team – is basically the rarest thing in the world of startups. Markets can be put into place. Right? You can pick a product, you can pick a market, but it's hard to pick a team.*

Naval: Absolutely. The first company I started had three founders. The second one had five. So, if it works, it works; if it doesn't, it doesn't. You should not go and remove founders just because you're over two.

But, I would say if you're a one-founder company and you're finding things to be just difficult and every day is a chore, you may want to consider bringing on, even at a later stage, an early employee or late founder – someone who can be your partner. It's that partnership element that's very important.

And keep in mind; human beings are pair-bonding creatures. We're evolved that way and so we're just designed to operate that way, and operating on your own for long periods of time in sustained difficult efforts is just highly unnatural.

2. How do you create a history together?

Nivi: You suggest people find someone that they have a history with – you wouldn't marry someone you just met – and that you should date first. And you suggest going through something difficult, like a prisoner's dilemma or a zero-sum game. How would you actually do that in real life?

Naval: Basically, what you want to look for are people who are cooperators who you can get along with. So, when I say prisoner's dilemma or zero-sum game, that just means go through a tough situation with them. A tough situation can be one in which they can gain at your expense, and that's really how you know someone. So, if you're dividing up some money or if you're trying to figure out who should do the dirty job or the hard work, you want to be with someone who's going to volunteer for that kind of stuff, who's going to volunteer to do a dirty job.

Steven Levitt and Stephen Dubner, who wrote *Freakonomics*, wrote a sequel to it called *SuperFreakonomics* that just came out, and in the prologue they have a very interesting and kind of funny little quip where they say: We were trying to figure out how to divide up this enterprise and we both wanted 60/40. At first it didn't feel right, and then when we realized that each of us was offering to give 60 to the other guy, and wanted 40 for himself, that's how we knew it was the right partnership.

So, I think you want to try and find that spirit of cooperation, because you will go through tough times, so you need to have some way to predict how the other person is going to behave in those tough times.

Nivi: *So, one practical way to actually play this game would be to lowball what you think should be your equity percentage in the business and see how they react to that.*

Naval: That's actually a really good test. Most people would fail that test, which is a good screen.

Nivi: Right.

Naval: But when your partner, in quotes, turns to you and says, yeah, that's great, I'll take 55, you take 45, or, I'll take 60, you take 40; now are you really going to get up and walk away?

Which is a natural segue into: how should you divide up a company amongst founders?

Nivi: Cool. Let's talk about that.

3. *How should you divide up the company?*

Naval: I've seen lots and lots of different examples and cases, and at the end of the day what I found is that, again, there are multiple ways to do it, but far and away the most stable configuration is one in which it's a 50/50 split. It's an inherent fairness.

Yes, not everybody is created equal, but it's very hard to measure when people's contributions are important. Some people's contributions are very important early on. Some people's contributions are important later on. It's very hard to measure how much effort someone is putting in. It's very hard to measure which crucial deal made the difference. So, I think a good rule of thumb is, start working at the same time, both work at the same salary or neither salary, and just make it 50/50.

I've seen cases where it's 55/45 or 53/47 or some unnatural number made up, and the bad blood surfaces five years down the road when you least expect it.

Nivi: And what about the case where you're basically hiring the first employee, perhaps calling him a co-founder, and giving him a large equity chunk – say 10% – but it's not a 50/50 split. Is that common or is that rare? What do you think about that?

Naval: It's not common, but it's not uncommon either. I think it's a pretty good way to go if you don't have a co-founder, or even if you do have a co-founder but it's someone who joins you early on

and they just do a stupendous job – they behave like a founder. And by behaving like a founder I mean they take responsibility for the outcome of the company. They work above and beyond the call of duty repeatedly. They stick with you through thick and thin. They voluntarily sacrifice their salary or even things that might seem like it's good for them, for the betterment of the company. And if you see someone who's doing that and becomes indispensable to the company, I'm a big fan of giving them a lot of stock and treating them like a late co-founder.

Now, later in the game you can't go handing out huge chunks of the company without getting in trouble with employees and investors, but you should do the best that you can because companies take five or ten years to build. They're just the sum of the people who are involved, and if you have a superstar person early on, you need to recognize that before you lose them.

4. *Who's the boss?*

Nivi: So, let's say I've got two co-founders with a 50/50 split. Who's the boss? How do I figure that out? Is there going to be a CEO? And say we have one board seat. So, we raise some cash from a small, early-stage VC fund. There's one investor on the board, one founder and one independent, or just one VC and one founder. Who's on the board? Who's the CEO? And who decides when a founder can be terminated?

Naval: Traditionally, this is a very difficult question. This is why it's very important to have a tremendous trust-based relationship with each other. You have to trust that even when you're not in the room, the other founder will take care of your interests as he or she would take care of their own.

If you don't have that level of trust with someone, then you cannot answer this question. Assuming you have it, it should almost be easy.

People should be saying: "No, no, you take it! No, no, you take it; I don't want to deal with it."

The truth is that CEO in a startup is a tough job. It's not a fun job. You deal with a lot of the crud. You have to clean up a lot of the employee issues, personality disputes, keep the investors up to date. It's actually among the less fun work. Anyone who thinks that CEO is a really fun and sexy job probably shouldn't have it. I would think

that with two good founders who trust each other there should not be much of a dispute.

Ultimately the board is the arbiter of control in the company, and the board is elected by the shareholders. It's quite common for there to be a voting agreement that forces drag-along. I think it's pretty important that if you want to have a say in your company and control in your company, then you reserve your right to vote as a board member.

So, in the two-founder case, you should not sign any voting agreement that allows just the other founder to select a board member or names and fixes a board member forever. It should be by mutual consent and you should be able to bring it up for re-election, and that will force there to be some level of good behavior and an alignment of interests.

In terms of who fires who or how does a founder get fired, you only want a founder to be able to get fired if –

- a) the other founders agree, and
- b) you also have some neutral, outside independent arbiter, which could be a VC or independent board member.

5. Do you even need a CEO?

Nivi: Here's a question. You've got a team of two guys who started a company, and maybe you've hired a few employees and you've got about five people. Do you even really need a CEO beyond the guy who is on the board who is somewhat on the hook to the investors, if there are investors on the board?

Naval: *I think you need a CEO in the sense that, on a day-to-day tactical level there has to be someone who's just making decisions so that not every decision gets caught in a situation of he said, she said; or you don't have people going to one person, and if they don't like the decision they go to another person and lobby. That's a very inefficient process.*

But at a strategic level, month-to-month you don't need a CEO in that nothing is going to happen that is huge and material for the business without both partners agreeing. So, in a five percent company, a CEO is not a guy who goes and cuts a deal or raises money without consulting his partner, but is a guy who decides on a day-to-day basis, yeah, we are going to go ahead and make that slight tweak to the side, or, yeah, tell a lawyer that that interpretation of the options contract is OK, and so forth.

Nivi: And then, in terms of getting terminated, at the very early stages where it's me and another co-founder and maybe a few employees, I basically don't want to be able to be terminated

without the consent of the board. This should be a board-style decision. Like, the CEO, whoever that is who has that title, can't get rid of me while we're in less than five employees or a few employees, right?

Naval: Yeah. Like I said, you want to have a process in place, and that process should require the consent of both the other founders and some independent arbiter. It's pretty hard to fire a founder, and it should be hard to fire a founder.

That being said, all founders should be vesting because the worst-case scenario is that if you have to let go of a founder and that person owns 30% or 40% of the company, there's no vesting so they walk off with all of it. Now you have very, very early-stage company with only 60% or 70% to go around and it's just not enough to build a company around.

6. *What skills do you need on the founding team?*

Nivi: One thing that you mentioned earlier is that one of the guys should be a builder, at a minimum, and another guy should be a seller, at a minimum.

Naval: Yeah. The classic examples are, of course, Bill Gates and Paul Allen, and Steve Jobs and Steve Wozniak, and so on. But it's also just more of an easy way of dividing the responsibilities and realizing what's important in the company. Selling is perpetual. You're selling investors, you're selling employees, and you're selling partners. You're constantly selling, so there just has to be somebody who's naturally good at sales and enjoys doing it, and will help pull in and bring in and manage the resources around the company.

Likewise, building a product is the core, heart and soul of the company, so someone has to focus on that. Engineers, design, implementation maybe even analytical marketing and any web-driven customer service – someone has to live, breathe, eat, and think the product. And although it's possible for one person to do both or for it to be divided differently, these are the two biggest jobs in the company and they're overwhelmingly large jobs. So, it just makes sense to divide them up along that basis.

I almost think of the person who's doing the selling as being the API to the outside world for the person doing the building.

Another way to think about it is someone who's inward focusing and someone who's outward focusing, and it's very important to realize that both of these are equally important jobs. Very often, the person who's outward facing, or more sales-y, will tend to garner an inordinate amount of attention and credit, and may even think that they're more worthwhile and more valuable. And that's just not the case; without a product the company is nothing.

Nivi: Here's a question. The guy who's the seller in the startups that works, I get the sense that he also has a lot of building ability, or at least an affinity for a product even if he can't build it.

Naval: I think that's right. You can't sell a product that you can't know well, otherwise you're sort of hand waving smoke and mirrors, which is why very often – not always, but very often – the best CEOs come from strong technical backgrounds and maybe were even involved in the development of the product early on.