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LATE STAGE VALUE CREATION OF FOUNDERS: ENTREPRENEUR VS MANAGER

Why do some Founder-CEOs remain active in their venture-backed startups after three years, and
how do they continue to create value?

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LIST OF ABBREVIATIONS

CEO	Chief Executive Officer
TMEE	Threshold Model of Entrepreneurial Exit
Unicorn	Company with a value of over \$1 billion
VC	Venture Capital

ABSTRACT

Entrepreneurship as a value-creating activity is vital for the economy, relying on the founder as a central force. Simultaneously, research shows that the value of a startup declines significantly if the founder stays beyond year three. I investigated why founders stay beyond the third year and how they create value during that time. To this end, I interviewed twelve founders and investors active in the startup ecosystem. I identified four different types of founders who stay in their company for different reasons, adding value by becoming managers or consciously taking on different roles remaining entrepreneurs and innovators.

Keywords: Entrepreneurship, Founder, Startup, Late Stage Value Creation

1. INTRODUCTION

The startup ecosystem originates from several new innovative ideas and technologies that change our lives (Colombo & Piva, 2008). For instance, Uber changed how we move, Amazon changed how we shop, and PayPal, Stripe, and N26 changed how we pay (Demil, Lecocq, Ricart & Zott, 2015). The global startup economy is worth over \$3.8 trillion in ecosystem value, representing more than the individual GDP of most G7 economies (Startup Genome, 2021). Consequently, investigating the functionality of the startup ecosystem is highly relevant because it has tremendous implications for the welfare of the economy (Gimeno, Folta, Cooper & Woo, 1997), as startups create employment opportunities and advance economic growth (Grimaldi, Kenney, Siegel & Wright, 2011; Roach & Sauermann, 2015).

A Startup is a temporary organisation “designed to search for a repeatable and scalable business model” (Blank, 2010). Entrepreneurs aim to transform their entrepreneurial idea and judgement into profit (Spender, 2014). The startup’s nature is provisional and dynamic, facing two options: 90% fail while merely 10% survive and grow into businesses (Griffith, 2014; Patel, 2015; Spender, Corvello, Grimaldi & Ripa, 2017). The reasons why startups fail cannot only be attributed to a lack of financial capital, but 20% of new ventures close due to “external job opportunities, disappointment with business ownership or [...] limited success” (Mayer and Goldstein, 1961). Brüderl, Preisendörfer and Ziegler’s (1992) study state that the founder’s skills and objectives dominantly influence the startup’s progress. Consequently, the survival and value creation of the startup depends critically on the central force, the entrepreneur (Estay, Durrieu & Akhter, 2013).

In recent years, scholars have shown increasing interest in entrepreneurship, specifically in the emerging field of digital entrepreneurship (Nambisan & Zahra, 2016; Zaheer, Breyer, Dumay & Enjeti, 2019). Research focuses on the entrepreneur (Beckman, Eisenhardt, Kotha, Meyer &

Rajagopalan, 2012; Colombo, Delmastro, & Grilli, 2004; Gimeno et al., 1997), the creation of the business (Blank, 2010; Estay et al., 2013; Shane & Stuart, 2002) and why it fails (Eisenmann, 2021; Griffith, 2014). Further, the question of why founders are replaced as CEOs and leave their businesses is investigated (Wasserman, 2003). Specifically, the literature scrutinises startups that attracted venture capital financing and their performance (Amit, MacCrimmon, Zietsma, & Oesch, 2001; Hsu, 2004; Miloud, Aspelund & Cabrol, 2012). Existing research indicates that forming relationships with external partners in form of VC investors is a priority for the success of startups (Kask & Linton, 2013; Pangarkar & Wu, 2012; Teece, 2010). Through their ownership stake, these investors considerably influence the CEO personnel (Pfeffer & Salancik, 2003).

However, there is a lack of in-depth research on digital ventures and their performance (Marmer, Herrmann, Dogrultan, Berman, Eesley & Blank, 2011; F. Zhao & Collier, 2016). Most studies examine early stage startups or failed businesses. Consequently, little is known about the performance factors of successful digital startups at the later stage (Zaheer et al., 2019). A literature gap exists regarding the influence of the founder's personality on post-launch performance and whether this influence changes over time (Zhao, Seibert & Lumpkin, 2010; Zuzul & Tripsas, 2020). Further research is needed to better understand the motivations to enter entrepreneurship (Amit et al., 2001; Wasserman, 2017), the entrepreneurial role itself and the characteristics that facilitate success (C. M. Beckman, 2006; Hsu, 2007; Zhao et al., 2010). Moreover, Wasserman (2017) recommends research on the founder's *control dilemma*, given his finding that startups, where the founder is still in control, are less valuable, particularly if the startup is older than three years.

This study's objective is to address these previously unexplored research areas. This study aims to discover the connection between the founder's motivation to start up, reasons to stay in the late stage beyond year three and methods of value creation. Focusing on venture capital funded startups

allows us to study successful, fast-growing companies where the CEO's responsibilities change rapidly to observe well the contrast between early and later stages.

The first part of this thesis consists of a literature review aiming to provide background knowledge about entrepreneurs, their motivation, favourable characteristics, reasons to exit and the role of venture capital. In the second part, I explain the methodology following the Gioia methodology (Gioia, Corley & Hamilton, 2012). The data collection consists of twelve interviews with founders and investors with more than three years of experience in the startup ecosystem. The findings in the third part will discuss four types of founders, why they are staying beyond year three and how they create value, followed by the discussion in which meaningful theoretical and managerial implications for entrepreneurs and investors are developed. I will conclude my paper by addressing limitations and topics for future research.

2. LITERATURE REVIEW

2.1 The Founder of the Venture

This thesis defines startups as new technology-based firms that receive funding from venture capital investors (Colombo & Piva, 2012). Moreover, I focus on the entrepreneur as the main person (Gartner, 1985) because, in most cases, the entrepreneur has the idea and develops the provisional business model (Wu, 2009). Consequently, they own the venture differentiating from a mere employee in terms of ownership and incentivisation (Wu, 2009).

2.1.1 Motivations to Startup

Motivation is the "ability to mobilise in the pursuit of goals" (Estay et al., 2013). It differentiates depending on the individual needs, values, desires, goals, expected rewards and intentions of the entrepreneur (Grigore, 2012; Man, Lau & Snape, 2008; Schindehutte, Morris & Allen, 2006).

Founders are said to be driven by the need for accomplishment, autonomy, independence and

control (Amit et al., 2001; Estay et al., 2013; Evans & Jovanovic, 1989), the need for financial gains (Verstraete & Jouison-Laffitte, 2009) or factors such as the lifestyle and psychological characteristics (Hamilton, 2000). Simultaneously, entrepreneurs receive, on average fewer financial benefits than they would have potentially received if they had been employed (Hamilton, 2000; Wasserman, 2017). In line with this, Amit et al. (2001) discovered that wealth attainment is not a greater motivation for entrepreneurs than non-entrepreneurs but that entrepreneurs rate their chance of building wealth higher in entrepreneurship than in alternative occupations. Kraft, Günther, Kammerlander and Lampe (2022) emphasise that overconfidence reduces the risk perception of actions, especially in early stages, thus promoting and facilitating entrepreneurship.

2.1.2 Value Creation in Startups

Speed is a crucial prerequisite for success as rapid progress enables ventures to quickly create a product capable of outperforming the competition (Chen, Reilly & Lynn, 2012; Dushnitsky & Matusik, 2019; Karpinskaia, 2022; Wasserman, 2017). In line with this, Romanelli (1989) states that the more and the quicker a new venture gains resources, the better its competitive position. Provided financial capital enhances value creation by accelerating and sustaining growth (Cooper, Gimeno-Gascon, & Woo, 1994). The capacity to iterate, change and adapt resources, customers, the team, product and business model strategically is a necessity to succeed (McDonald & Eisenhardt, 2020). Throughout the process, a great vision must be formulated and strived for (Zaheer et al., 2019). Later, startups should safeguard this spirit of the early stage (Gulati, 2019).

2.1.3 Defining and Differentiating Characteristics of Founders

The founder's knowledge and decision-making are decisive for the success or failure of the business (Casson, 2005). Entrepreneurs are distinguished through their high need for independence and an internal locus of control (Mintzberg & Waters, 1982; Rotter, 1966). Moreover, they are

willing and able to handle uncertainty and ambiguity well (Kihlstrom & Laffont, 1979; Schere, 1982) and have a high level of self-efficacy (Mc Ghee & Crandall, 1968). The study by Zhao et al. (2010) states that the image of the entrepreneur as a high-risk taker and extrovert is not accurate and negligible. In contrast, discovering and creating new opportunities and being enthusiastic about starting up are more relevant entrepreneurial traits (Murnieks, Mosakowski, and Cardon, 2014).

Zuzul and Tripsas (2020) study differentiates between revolutionary founders and discoverers. They identify revolutionary-oriented founders as those who want to overturn the status quo and build something fundamentally new. However, these founders would rather hold on to the original revolutionary idea than change it, even if they must accept a worse performance. In contrast, discovery-oriented founders seek to build successful businesses through incremental improvements. Discoverers look for an opportunity, continuously adapt and experiment with their business model to act faster and exploit the competitive advantage speed (Zuzul & Tripsas, 2020).

“Entrepreneurship is a multidimensional process and personal traits are just one component” (Gartner, 1988). However, scholars agree that human capital is the main characteristic determining the development of startups (Feaser & Willard, 1990; Shane & Stuart, 2002), creating a competitive advantage (Colombo & Grilli, 2005; Feaser & Willard, 1990) and increasing the likelihood of VC funding (Hsu, 2007). Gimmon and Levie (2010) agree that the general technological and business management skills of startup founders enhance the probability of the firm’s survival. Aminova and Marchi (2021) found a positive correlation between the founder’s education and performance. However, nowadays, it is more important to learn continuously than to obtain a specific degree because knowledge is easily accessible on the Internet (Aminova & Marchi, 2021).

Furthermore, initial startup and industry experience can positively impact resource acquisition, valuation and growth (Baum, Locke, & Smith, 2001). Eesley and Roberts (2012) state that serial entrepreneurs profit from their learning experiences. Therefore, they are more likely to found high-

growth firms with higher sales and lower failure rates, especially in familiar industries and technologies (Brüderl et al., 1992; Gimeno et al., 1997). However, when founders face an uncertain and unfamiliar environment, talent and skills like abstract reasoning and divergent thinking are more important than prior experience (Eesley & Roberts, 2012). The study by Kotha et al. (2022) investigating unicorn founders resulted in 60% being first-time founders.

Existing studies of entrepreneurship highlight the importance of overconfidence for entrepreneurs to cope with uncertainty, high risk and fast decision-making (Busenitz & Barney, 1997; Stevenson & Gumpert, 1985). However, Tversky and Kahneman (1974) argue that these entrepreneurs perform biased decision-making. Kraft et al. (2022) conclude in their study that although overconfidence enhances opportunity assessment and the step towards the creation of the venture, the effect of overconfidence becomes negative in the later stage of the start-up process, i.e., decreasing the venture performance. This study suggests that the role of the entrepreneur changes over time, requiring different qualities for the venture's success. Early stage founders are responsible for everything, facing a zero-sum game, where occupying with raising funding means less time for product development (Hsu, 2007). In contrast, the CEO's skillset changes as the company grows, shifting from technical product-related issues to building a multi-function company (Wasserman, 2003). At this point, Founder-CEOs can be constrained through a diverse skillset, an attachment to early employees, initial ideas, strategies and ways of working (Adomdza, 2008). Cardon, Wincent, Singh and Drnovsek (2009) developed three entrepreneur identities in these different maturity stages: The first, the *inventor*, is passionate about "identifying, inventing, and exploring new opportunities"; the second, the *founder*, enjoys starting a business and marketing the opportunities; and the third, the *developer*, has the skills to nurture, grow, and expand the business (Cardon et al., 2009). Each identity fits different optimal skills, but still, each phase can be mastered by the same person, but with varying levels of success or invested workload.

Top managers ensure quality and performance in every organisation, determining success and survival (Drucker, 1985). The founder and manager CEOs are critical for direction and performance (Wasserman, 2003). Nevertheless, Stewart and Roth (2007) distinguish them in terms of the need for achievement, which is higher for founders, especially venture-funded entrepreneurs, than for managers. Entrepreneurs are characterised by the capability to make fast decisions as well as to attract talent and develop a talent pool (Wu, 2009). In contrast, managers are better at thinking analytically, prioritising urgent problems and finding feasible solutions (Wu, 2009). In addition, manager CEOs often have more professional experience and receive higher salaries but own significantly fewer shares and are bound by longer vesting periods. (Wasserman, 2003).

2.1.4 Reasons to Leave the Business

In venture-backed startups, the founders, investors and other shareholders ultimately aim to sell their shares to exit the company (Elitzur & Gavious, 2003), which can be an event that initiates the founder to leave. However, the founder's choice to leave before or stay beyond this event depends on possible alternative occupations. A higher "present value of the economic and psychic benefits over the lifetime" elsewhere pushes the founder to leave (Porter, 1976).

To better understand these complex factors influencing the decision to exit, Gimeno et al. (1997) developed the Threshold Model of Entrepreneurial Exit (TMEE, see Appendix A), widely applied in recent literature (DeTienne & Cardon, 2012; Pinkovetskaia, Berezina & Sverdlikova, 2020). The business's survival depends not only on economic performance but also on the performance threshold expected by the entrepreneur, determined by three factors, "the entrepreneur's human capital characteristics, psychic income from entrepreneurship, and cost of switching to other occupations" (Gimeno et al., 1997). The first factor outlines the entrepreneur's opportunity cost of the financial gain, e.g., the salary of an alternative occupation increases the threshold to leave the

business. The second factor, psychic income, decreases the threshold to leave. It is created by nonmonetary returns, e.g., personal satisfaction of being an entrepreneur, feeling in control and independent. The third factor, switching costs, refers to the “difficulties, obstacles and monetary costs” occurring when exiting the business and changing the profession, decreasing the threshold (Gimeno et al., 1997). The entrepreneur’s human capital, such as education, influences the opportunity cost of alternative employment. High human capital increases the opportunity cost, creating the need for the high economic performance of the startup for the founder to remain active (Cressy, 2006). High opportunity costs signal trust to external parties because the founder must firmly believe in the future financial success of the business to give up this high-paying occupation.

Suppose the founder decides to leave the company, it has a “disproportionately negative impact on the likelihood of organisational survival” (Carroll, 1984) because the business must transition “from a one-person, entrepreneurial style of management to a functionally organised, professional management team” (Hofer & Charan, 1984). To professionalise the business, the CEO must develop new formalised routines, establish policies and remain consistent with the organisational goals and purposes (Wasserman, 2003). Although the two roles differ significantly, on average, 55% of founders remained CEO up to and including IPO (Baker & Gompers, 2003).

2.2 The Role of Venture Capital

2.2.1 Value Creation of VCs within the Entrepreneurial Ecosystem

Compared to traditional financial intermediaries, VCs offer added value beyond the deployment of financial capital, e.g. by supporting business professionalisation (Bygrave & Timmons, 1992; Gorman & Sahlman, 1989). A proof point for the value creation is that VC-backed startups went public four years earlier (Baker & Gompers, 2003). Due to this additional value created by VC

funds, founders are willing to give up ownership equity (Hsu, 2004). However, with outside capital and advancing age, the founder-CEO will more likely be replaced by the board (Wasserman, 2003).

2.2.2 VCs Pushing Founders to Leave

Investors want to protect their investment and exert influence by occupying a board seat connected to voting rights and control over strategic decisions (Pfeffer & Salancik, 2003). As the business develops, the entrepreneur is likely to lose influence, because he has given up ownership to meet the resource needs of the business. To either sacrifice the growth of the venture or the control of the startup defines Wasserman (2017) as a control dilemma. Thus, founders face a tradeoff between the added value of outside investors and the associated transfer of control.

The fact that the founder relinquishes control to attract VC funding and increase the value of the startup contradicts agency theory, which predicts that agency costs increase when the founder relinquishes shares, causing the value of the startup to decrease accordingly (Fama & Jensen, 1983; Jensen & Meckling, 1976). Wasserman's (2017) research opposes the agency theory rationale, stating that "startups in which the founder is still in control of the board of directors and/or the CEO position are significantly less valuable than those in which the founder has given up a level of control". The tradeoff is particularly pronounced for startups aged three years and older (Wasserman, 2017). Consequently, in every decision, an entrepreneur faces the tradeoff of giving up control to attract the required resources or remaining in control.

Beyond this, Wasserman (2003) identifies a *paradox of success*: If skilled founders reach certain milestones of success faster, they often reach their limits faster because they do not have time to expand their skills due to the company's rapid growth. Consequently, successful founders are replaced by external CEOs earlier than founders with little success (Wasserman, 2003).

In the high-risk, high-return investment environment, VCs emphasise the team's ability to operate in this dynamic environment (Hsu, 2007). If the due diligence reveals weaknesses in this regard, investors will recommend a change in management (Wasserman, 2003). To avoid this pushout, founders should actively build the necessary skillset early on, recommends Wasserman (2003). However, an external CEO can help by professionalising the venture, thereby maximising its value for all shareholders (Hellmann & Puri, 2002). Indeed, the founder can continue to play an active role in the business or board, in case an external CEO is appointed (Hellmann & Puri, 2002).

Overall, the founder's decision to leave is investigated prominently in literature. Since many founders leave their startups after the early stage, research argues that founders leave because they feel overwhelmed by the new role and changing tasks for which they may not have the appropriate skills. Especially in startups backed by venture capitalists, investors watch closely to see how well the founder-CEO fits the next phase of company growth. However, the puzzle lies in the fact that some founders stay beyond the early phase. Questioning why they stay is particularly crucial since these start-ups are less valuable on average (Wasserman, 2017). This paper aims to identify the reasons why founders stay and examine the ways in which they create value at this stage by addressing the following research question: *Why do some Founder-CEOs remain active in their venture-backed startups after three years, and how do they continue to create value?*

3. METHODOLOGY

3.1 Research Design

The empiric research is conducted utilising a qualitative research method, as it is the most suitable approach for a research question focusing on a "why" and "how" question (Yin, 2009). The qualitative approach allows us to contextualise the meaning of non-numeric data such as interviews (Easterby-Smith, Jaspersen, Thorpe & Valizade, 2021). The interviews serve as primary data

forming the basis for the inductive approach chosen to do justice to the explorative nature of qualitative research. The interviews create a shared social reality, which allows for exploring contextual factors beneath the surface (Andrews, 2012; Buber & Holzmüller, 2007). I followed the Grounded Theory approach by Glaser & Strauss (1967) and the recognised and widespread Gioia methodology (Gioia et al., 2012). The basis for this choice is my ambition to explore actions and interactions of people, emergent concepts and their linkages to explain relevant phenomena under investigation (Gioia et al., 2012; Williams, 2011).

3.2 Sampling

I conducted in-depth interviews with twelve expert interviewees (presented in Appendix C). My sample includes VC-backed founders (seven) with more than three years of experience in their active business and investors (five) active in the startup ecosystem. I focused on German digital businesses distinguished by size (from 2 to 500 employees), maturity of the organisation (from one to eleven years), provided financial capital (up to 50M) and business model (B2C and B2B). The resulting heterogeneous perspectives within the sample provided valuable unique insights.

I chose to utilise purposeful theoretical sampling combined with snowball sampling. The EBS and Nova Alumni network and the VC network from my internship at coparion (VC firm in Cologne, Germany) supported my interviewee search. I pre-selected high-potential interviewees capable of providing helpful information about the phenomenon under investigation: The late stage value creation of founders and why they stay (Yilmaz, 2013). I contacted the selected interviewees via email, LinkedIn or phone. I continued this until the data obtained from the interviews became repetitive or no new data emerged, defined as theoretical saturation (Glaser & Strauss, 1967).

3.3 Data Collection

To collect the data, I chose a semi-structured interview style, which, in form of the interview guide, provides a structured, systematic, and more comparable basis for the interview but leaves me, as the interviewer, the flexibility to adapt the questions in a discovery-oriented way. Moreover, the conversation can take a natural, informal course, with both parties using their own words. (Longhurst, 2003). I adapted the interview guide to emerging ideas and findings occurring during the research process (Gioia et al., 2012). The interviews were conducted in German and English during the period from October to November 2022. Due to the different locations of the parties and busy schedules, I conducted the interviews using the video platform Microsoft Teams. Most questions are structured open-ended, e.g., “Why did you start your business?”, “How important is the founder for the business?”. The detailed interview guide is enclosed in Appendix E. The interviews lasted approximately 30 minutes and included the personal background, motivation to start up, key characteristics and skills necessary to succeed at the early stage compared to the later stage. The interviews were recorded with the interviewee’s consent and transcribed using the software program amberscript, resulting in 91 pages of interview material. To supplement this, I drew on real and public cases of startup founders that I researched in public newspaper articles. The findings of this study will be shared with the respondents upon completion of this thesis.

3.4 Data Analysis

Following the data analysis approach of Gioia et al. (2012), I organised the primary data of the interviews in informant-centric 1st order codes that occurred repeatedly. For this purpose, I used the qualitative data management software MAXQDA. I analysed the interviews inductively by reading them line by line (Locke, 2001), marking and coding essential passages, which constitutes the in-depth coding process of Strauss and Corbin (1998). Part of the method is also the constant

comparison between existing and new codes (Glaser & Strauss, 1967; Strauss & Corbin, 1998). Through the adaptation, merging and separation of the codes, I obtained a set of 20 unique codes in the end. To maintain data integrity, I labelled these concepts close to the interviewee's terms (Gioia et al., 2012). In the next step, I organised the 1st order codes into four overarching 2nd order themes, namely four types of founders, referring to the research question and existing theory. From these, two aggregated dimensions emerged: Stay as Founder CEO and Stay in a different role (non-CEO). To present a theoretical perspective (Gioia et al., 2012), I developed a data structure (see Appendix B) as a visual representation linking empirical evidence to the emerging theory (De Massis and Kotlar, 2014). All extracted quotes included in the findings were translated using the tool DeepL and then checked for grammatical correctness and meaningfulness. For reasons of confidentiality, the interview transcripts are not included in this document.

4. FINDINGS

In my findings, I identified four types of founders with different motivations to stay in their company beyond the third year and varying ways to add value (see Findings Overview in Appendix D). These different types are not mutually exclusive, meaning the motivation and reason to stay can shift or diminish over time. My results suggest that year three is not a specific milestone for every company. Interviewee D (15) supports this finding by stating that investors have a time horizon of “around ten years or longer” in mind when they invest. However, interviewee J (18) acknowledges that VC funding inevitably goes hand in hand with a path of rapid scaling.

4.1 Founder in Control

The first type of founder identifies as the best person available and seeks to maintain full control of the CEO role. Their reason for staying is the goal to continue to significantly drive the value of their share of ownership in the business. This type of founder believes that their unique skills,

characteristics, willpower, vision and knowledge about the business, industry and startup ecosystem qualify them as the best-suited person to manage the company.

Moreover, specific business models in the B2B sector reinforce the importance of the founder. For example, interviewee F (39) describes that as founders, they were responsible for the central customer contracts. Interviewee J (16) highlights that neither a specific kind of experience, for example, five or six years at McKinsey, nor a specific age can qualify external managers for the founder job. These founders create the most value by acknowledging their shortcomings and hiring complementing talent in the second layer management. Interviewee J (16) confirms that they are supported by “trustworthy and reliable people on the second level, who also have a lot of experience” (Interviewee J, 16). Combining the founder’s in-depth industry knowledge with their people management skills and ability to best represent the company to customers and partners adds the most value. Moreover, another person with the required skills is not available, or at least not at an attractive price point. As interviewee J (14) describes, “having a great people manager with the relevant technical skills, you simply cannot afford”. Interviewee D (27) supports this fact by stating that founders often do not pay themselves high salaries in the early stage. Interviewee C (12) agrees that higher salaries are easier to achieve elsewhere “because ultimately it is not a get quick, rich scheme” (Interviewee C, 12). Nevertheless, interviewee G (8) recognises that his “paper wealth, according to the most recent valuations, is of course much, much greater than all that I would have earned anywhere else in a normal law firm”. The *founder in control* is motivated by their business ownership, the prospect of success and the financial benefits of building the best possible business. In addition, interviewee I (25) describes his motivation to stay as follows:

“Of course, we also want to have financial success. [...] So yes, so we are exit-driven. It just makes our company better. When the time is right, we consider an exit, but it does not mean that it is a must. [...] As long as it is fun, and I can still add value here, and there is still enough to change, we are not yet at the end of our journey.”

Interviewee H (16) adds that the motivation to stay, is the business's growth, which "makes this thrill. The cool thing is you always have something to do and there is always potential to improve something. You cannot stop there." When asked the reason why interviewee F stayed in the company, although one co-founder left, interviewee F (27) explains:

"When you found a company in threes, [...] the step of leaving the company tends to be the smarter move, because you are relatively sure that the other two will still do it 90% well - maybe not 100%, but at least 90% well. And as long as you are fully vested, you get all the shares. That is why it is a classic prisoner's dilemma. The one who moves first, so to speak, wins. If everyone moves, everyone loses."

The founders who stayed must ensure to build the business successfully, because no one else would do it otherwise leaving the business to fail. Regarding the necessary managing skills, interviewee J (10) describes it as a "learning by doing" process. Similarly, interviewee I (17) describes their experience as learning the new skills "the hard way, which was also the reason for our slower growth at the beginning". Besides, these founders learn from mentors, former CEOs, "just from the way they express themselves, the language and see how they act, that is helpful to learn a lot" (Interviewee J, 10). This founder type can transform into another type over time.

4.2 VC's Optimal Case: Seamless Founder to Manager Transition

The transition from *founder to manager* is critical, holding the risk of breaking the company. Consequently, a frictionless transition by the founder is the optimal case, which enables the founder to add value continuously profiting from the early stage experiences. "If a founding team manages to grow through it [the transition], that is an advantage", states interviewee A (34). Interviewee K (10) agrees that:

"Entrepreneur-led businesses operate and proceed better. It also makes sense that if you have someone new every two years, there is no consistency compared to someone who already knows the whole company inside out, and of course, the founder has a completely different incentive because he or she owns shares in the business."

Similarly, interviewee D (27) points out that it is the best case, when “the founder is leading the thing himself or herself from pre-seed to IPO” while learning quickly through the new tasks. In fact, not only the company needs to be optimised, but “half the battle is optimising and improving yourself” (Interviewee H, 26). The founder can build their management style and company culture regardless of the company’s size. For example, giants like Amazon still identify as a startup, because they are “very much driven by the entrepreneurial DNA” (Interviewee K, 8). The tasks change when transforming into a manager, and different skills are needed. Later, the founder must:

“Be able to delegate and execute certain areas well and have a vision and a clear plan while approaching things strategically and logically. [...] The founder is much more involved in hiring, in the big strategic issues. There are simply many contacts and a second bank, in the sense of a bank that has the founder’s back.” (Interviewee D, 23)

Moreover, the founder is “the visionary string-puller, who somehow has to manage a multi-level organisation” (Interviewee A, 20). However, to keep up with the rapid speed of the company’s growth during “a year or two is a tough journey” (Interviewee I, 17). Therefore, mental strength is the crucial prerequisite for founders to transform into managers successfully. (Interviewee K, 6).

Interviewee K (6) continues that mental strength can be learned, for example:

“Athletes, who have done some competitive sport, are outstanding entrepreneurs because they can deal well with adversity and difficult circumstances, as well as people with a migration background, who have somehow moved from A to B and had to fight their way through a new language, and new environment, sometimes even several times.” (Interviewee K, 6)

Moreover, persons that experienced this challenging high-performance environment in demanding universities or prior occupations, e.g., strategy consulting, can have an advantage similar to second-time founders by having developed this mental strength (Interviewee K, 6). “But being challenged for the first time in a company, where you start yourself, is maybe not the best environment” (Interviewee K, 6). Without this prior experience, one must become a self-made manager, which means that one must learn fast without structured training. For this, the right mindset of lifelong learning is vital because: “You will intuitively do many things right, but you

will also do 10% wrong or more. And then it is about how do you deal with failure? That is what makes great management” (Interviewee H, 12). This high willingness and ability to learn new necessary skills characterise the value add of this type of founder. To support this learning process, Interviewee E (29) proposes forums like EO, Entrepreneurs Organization with other experienced founders and “shareholders, who have also experienced this transition many times”. Interviewee F (37) estimates that roughly 20% of entrepreneurs become good managers. However, interviewee L (28) believes:

“The founder has proven that he is super adaptive by founding the company and walking the path. That is why many founders always manage to stay at the top. [...] But it requires a certain change in how you manage your company, communicate, and make decisions. But from my point of view, founders can usually do that very, very well.”

4.3 Repeat Founder

The third type of founder staying in business is the *repeat founder*. Instead of transforming into a manager, these founders aim to stay entrepreneurs in the long-term, either in their own company in a different role as innovators and optimisers or by starting a new venture. For interviewee G (22), the goal is to “never become a manager, but always remain a founder [...] and perhaps re-found a kind of company within the company“. Interviewee G (28) adds that he would: “Switch to the supervisory board and start something new again, but only at the moment when the business can really function well without me.” Similarly, interviewee B (28) experienced: “Most of the entrepreneurs I know are keen to start doing something new again”, because “the vast majority loses interest in the long run, because being a board member or CEO of a listed company is not really fun for people, who have previously built and founded such a company.” Interviewee F (57) agrees and reflects that:

“I would rather leave the company sooner than later because, in the end, it is all lifetime. We do not have that much time to live, and then the years are over. And then there is always the question: What is the added value of one’s own person? If you feel that it is no longer

significantly higher than anyone else who might be able to do it, then from my point of view, it also makes sense to pass on the baton.”

“Founders are often explorer types that need new impulses”, interviewee L (30) adds. Another reason may be that these founders do not enjoy the management tasks and have no desire to lead a multi-layered organisation or feel overwhelmed by the new tasks, especially as the “founder realises that the skillset is no longer quite the right one for what is needed [...] And there are simply people who do it better” (Interviewee D, 27). This year, the founder of the seven-year-old startup Volocopter left the company and handed over the CEO role to an industry expert (Manager Magazin, 2022). This founder type does not want to “become the limiting factor of their idea and their company themselves” (Interviewee B, 22). In their quest for the highest added value and the best interest of the company, these types of founders admit that they lack motivation and skills, and therefore hire a better suited person as external CEO to handle the management tasks, which allows the founder to withdraw from the day-to-day management (Interviewee E, 29). Potential other roles for significant value creation of the founder can be, e.g., president or product ambassador, a position where the founder is “really very, very good at and then transfers the development of the organisation to other people, who can do it and have the skills” (Interviewee B, 22). For example, the former founder of air taxi startup Lilium “remains with the company as chief engineer and board member,” while an external CEO is appointed (Malter, 2022). To make this decision, the founder can self-reflect and “write the perfect job description and then ask yourself, would I hire myself to fill that?” (Interviewee C, 20).

The repeat founders enjoy the challenge of starting a new venture, which fits their skillset better and where they can leverage their entrepreneurial experience and network. Interviewee E (31) explains: “Many founders simply leave their company at some point or go into the board and make something new big again because they recognise their strength at this early stage”. Interviewee J

(22) highlights that after the first startup, his network transformed utterly and now “you can reach almost everybody if you want to”. Interviewee J (22) continues to estimate that “if I had the experience then, that I have now, we would have had at least three times the revenue and a different growth story”. These repeat entrepreneurs enjoy the first phase, where:

“You are the one who is the jack of all trades, who somehow has to do everything from setting up the desk to strategic planning in the equity pitch. [...] You are a bit of a tireless builder and designer. You recognise mistakes quickly, iteratively create something new and just do not let yourself get rattled.” (Interviewee A, 20)

With time and development, the goal is “that we can simply leave, and the company continues to run well without us” (Interviewee G, 14). Thus, the vision and culture within the company must be formalised, and the succession must be planned to ensure survival if something terrible happens.

The repeat founders are exit driven, but this process often takes more than three years. Therefore, they search for new opportunities within the firm and outside simultaneously. Their motivation is strongly driven by the freedom to make their own decisions independently and self-efficiently, to shape their own business aiming to be successful, thereby influencing the world. Interviewee G (6) states, “I do not want to be an employee. I want to push things forward myself. My motto is actually always to go a bit new ways.” Interviewee B (16) adds: “The freedom to deal with new topics that I like - for me, that is entrepreneurship.” Some developed the venture through ideation or responded with an open mindset to upcoming opportunities, even during university. Interviewee L (39) explains: “Entrepreneurs often take the opportunity, even though the plan is different, and usually, something good comes out of it.” When they leave, “most of the time, founders stay connected to the company, as advisors, as non-executive directors or else” (Interviewee D, 29), thereby being able to give entrepreneurial impulses from an outside perspective. Although interviewee L (22) finds it “a bit of a misconception that the old founder can still ultimately make the decisive decisions in the advisory board.” Nevertheless, the transition from founder CEO to a different role

must always be communicated clearly and respectfully. In any case, leaving is a personal decision, which does not diminish the success of the company:

“If you simply have a company that is perhaps very, very successful, that is growing very, very strongly, and you do not grow fast enough into this management, you are still an incredibly successful founder. But it does not make sense for you to remain CEO if you cannot manage this next phase of the company.” (Interviewee A, 24)

Interviewee B (22) agrees by stating that “even entrepreneurs, who cannot do everything, can be brilliant entrepreneurs, because they make the right decision to hand over tasks to others”.

4.4 Lock-in through Exit Contract

The fourth motive for founders to stay is due to the contractual clauses of the exit contract, a *lock-in*, of the acquirer, e.g., a strategic buyer. At times, it is not the founder’s motivation to stay but a mandatory commitment to continue for one to three years after the acquisition to add value by completing the business integration and transferring knowledge. Interviewee F (21) puts it like this:

“The companies are not only bought because of the companies but also because certain people are sitting here. And, of course, the buyers want to make sure that the same people are still sitting around, let’s say, for a while.”

Interviewee B (20) highlights the importance of the founder for Venture Capital investors, which is similar to the acquiring parties, because:

“The founder is the central driver of the company, (...) so the idea is not so relevant, but there is always this sentence with real estate, it is the location, location and location, that counts. For the three most important criteria Venture capital counts founders, founders and founders.”

In this decision to keep the founder in the business, the founder’s skillset is not inevitably considered. The founder might even be overwhelmed with tasks or not interested in pursuing the daily work in this new organisational setup, limiting the opportunity to create value. Of course, the motivation to enter the contract is great because it is the possibility to receive a monetary value for the hard work and ownership shares in the company. Furthermore, it is the ultimate goal for VCs financed businesses to work towards an attractive valued exit offer. Often, the founders look

forward to leaving the mandatory position within the acquirer's firm to become entrepreneurs again. In the example of interviewee K (2), he realised after selling his company and working in this new position that "entrepreneurship is what I enjoy most".

5. DISCUSSION AND CONCLUDING RECOMMENDATIONS

5.1 Theoretical Implications

5.1.1 Different Factors of Psychic Income are Critical for the Decision to Stay

This study complements the *TMEE model* by Gimeno et al. (1997) by investigating the specific case of venture backed entrepreneurs with high human capital who run successful businesses, thus studying the characteristics that facilitate success (Beckman, 2006; Hsu, 2007; Zhao et al., 2010). The study adds that the unobserved threshold level of performance is relevant for the decision to stay, especially the psychic income generated by the founders through their position. Justifying this, four distinct types of founders staying in their business above the temporal normality adding value in different ways, are presented to the literature. The main factor generating psychic income differentiates for each of the four types between control, acquiring new management tasks, independence or financial control. The founder who is in control (4.1) generates psychic income from being in control and the self-efficacy of creating the business, corresponding to Amit et al. (2001) and Estay et al. (2013). The type of founder who becomes a manager (4.2) generates psychic income from continuing to manage a multi-layered organisation while having the necessary ability and willingness to learn new management skills complementing Aminova and Marchi (2021). Both types aim to continue leading the company as CEO. In contrast, the repeat founder (4.3) is motivated by the independence and the sense of newness experienced as an entrepreneur (Amit et al., 2001; Estay et al., 2013). Consequently, this type of founder stays involved as long as the organisation can provide said experiences. If not, they reduce their involvement to an advisor and

board member or leave. The type of founder, locked in through an exit contract (4.4), decided to stay to fulfil the contractual agreement due to the prospect of financial gain (Verstraete & Jouison-Laffitte, 2009). The two latter types (4.3 & 4.4) do not want to stay CEO in the long run.

This study contributes to the literature by providing a rationale for why the founder-to-manager transition may fail, namely due to a lack of motivation to aspire to the managerial role and acquire the necessary skills rather than simply a lack of specific skills per se. This paper emphasises that failure in the transition from founder to manager does not diminish a founder's success.

5.1.2 VC backed Startups are Led by Discovery Oriented Founders

Establishing the fact that VC investors specifically look for the characteristics of a discoverer in founders, this paper complements Zuzul and Tripsas's (2020) finding that discovery-oriented founders have a competitive advantage. All interviewees described themselves as discovery-driven and highlighted their success factors in the form of high speed, willingness to learn, openness to opportunities and feedback receptivity, which relate to the characteristics defined by Zuzul and Tripsas (2020). Generally, the founder or the founding team is considered the most important factor by both parties, founders and investors. Their skills are perceived more important than the business idea, complementing Aminova and Marchi's (2021) emphasis on the ability to learn continuously.

5.1.3 Paradox of Success Pushes Repeat Founders to Step Down from CEO Role

This paper adds to Wasserman's (2003) paradox of success that the paradox applies particularly to first-time entrepreneurs, indicating that founders leave earlier, when the startup is more successful. For second-time entrepreneurs or those who have already acquired the necessary mental strength, this paradox of success can be overcome more easily. However, the rapid growth and early success lead to the founder being faced earlier with the pivotal decision to either choose to leave the company or actively grow into the role of managing director.

5.2 Managerial Implications for Founders and Investors

Founders motivated by their pursuit of freedom and independence stay with their companies as long as it suits their interests while being open to new opportunities. The prospect of realising the financial upside through their work in the company is a motivating factor to stay. These founders stay as long as they generate this psychic income and feel challenged by their tasks. In contrast, founders striving to become managers are motivated by being in control and continuously improving and optimising one's skillset to master the management challenges. At this later stage of business maturity, these founders already demonstrated their ability to acquire the necessary skills and overcome any challenge. Hence, it depends on the motivation to take on this managerial challenge versus the alternative to start up applying newly gained entrepreneurial skills.

In general, it is easier for founders to become managers than the other way around. To decide to stay, it helps to reflect honestly on your skills, but especially on your interests and motivation and think about whether this outcome makes you the ideal person to lead the company and its employees in the best interest of the shareholders. Motivation trumps existing skills, as the founder's ability to learn new skills, has already been proven at this late stage.

5.3 Limitations & Future Research

In an effort to be fully transparent about my research, I acknowledge the limitations I faced. I am aware that the feedback rate among successful founders at this C-level stage is low, as they are rarely willing and able to invest their time. My sample is limited to mainly the male perspective with only one female respondent, although I have made considerable efforts to find and contact female founders. Thus, it is reasonable to assume that fewer women occupy this position. The chosen qualitative research approach does not aim to make statements about the population but to identify some reasons why founders stay and some ways to add value. Consequently, I cannot

present generalised findings but add specific knowledge and individual experiences to the research stream. This may be limited, as I may not have captured all reasons and options of the population.

Future research can address these limitations by utilising quantitative methods to identify the most frequent of the four proposed reasons to stay within founder populations and investigate which pathway leads to the highest value of the business in the long term. Moreover, focusing on female founders can explore the extent to which their perspectives on this topic differ from my findings. In addition, future research can compare my results focusing on Germany with those from other countries. Cultural differences can lead to additional insights and diversified results. Future studies could look at specific industries to see if founders stay longer in some industries.

5.4 Conclusion

This thesis investigates why venture backed founders stay in their businesses beyond year three and how they create value. The qualitative analysis included twelve interviews with investors and entrepreneurs. I have gained valuable insights into how the role of founder and CEO is perceived and performed in the early to the late stage. Based on this empirical research, I propose four types of founders that are not mutually exclusive, why they stay in their business and how they add value. Two types (4.1 & 4.2) stay in the company as Founder CEO and developer, motivated by the new challenge, learning new skills and the self-efficacy of creating value for their company. In contrast, the other two types (4.3 & 4.4) do not aspire to become CEOs but derive their psychic income and motivation from the entrepreneurial early stage tasks. They recognise their strengths in building a team and a company from the ground as innovators and founders of new opportunities. These developed types of founders contribute to further theory development and provide evidence for further empirical research.

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7. APPENDIX

7.1 Appendix A - TMEE Model

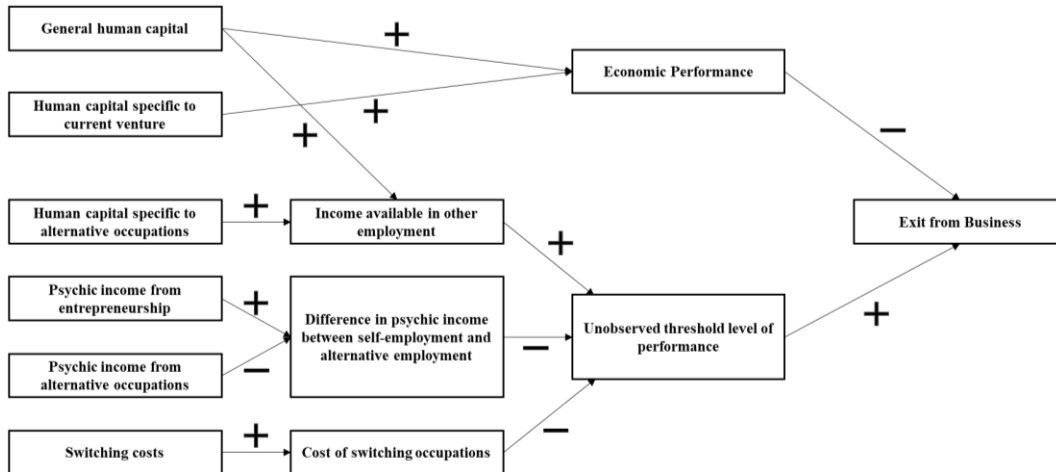


Figure 1. Threshold model of entrepreneurial exit: Human capital considerations

7.2 Appendix B - Data Structure

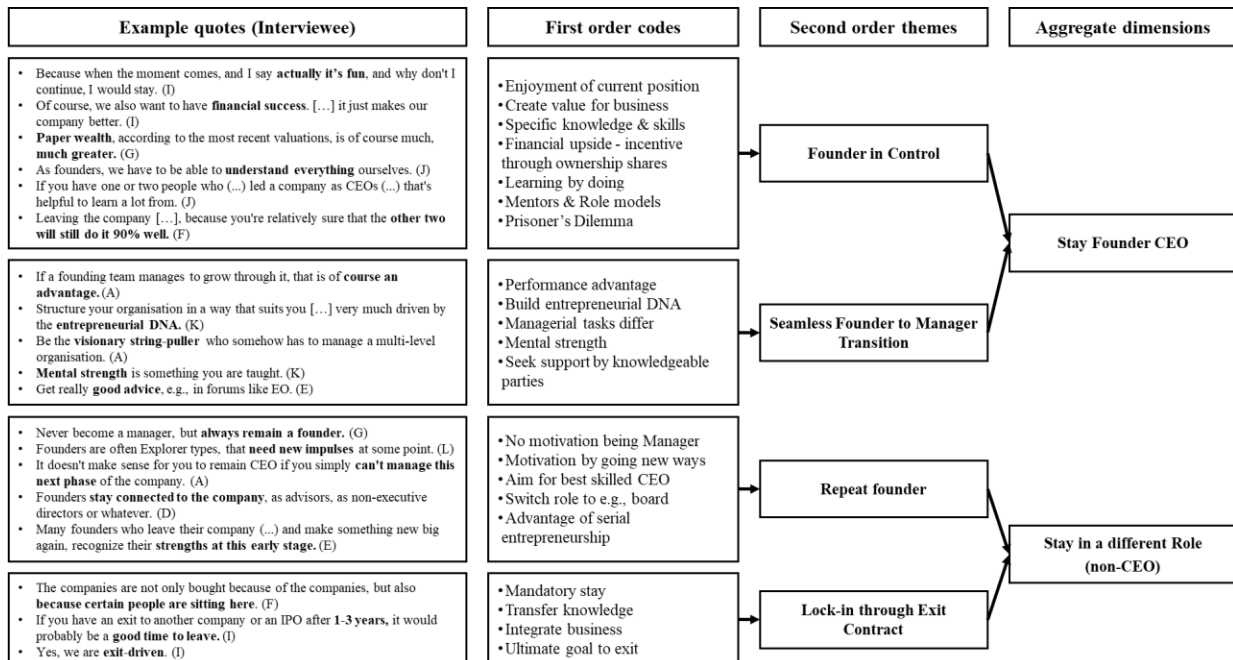


Figure 2. Data Structure

7.3 Appendix C - The Studied Interviewees

	Role	Experience	Background	Nr. of Employees	Funding amount	Industry
A	Managing Director	Founder & Investor	Business	21-50	1st Fund	FinTech & Mobile App
B	Founding Partner	Founder & Investor	Business	51-100	7th Fund	FinTech & Consulting
C	Principal	Investor	Business	11-20	2nd Fund	FinTech & InsurTech
D	Principal	Founder & Investor	Business	51-100	7th Fund	FinTech & PropTech
E	Founding Partner	Investor	Business	11-20	First Fund	FinTech & Consulting
F	Managing Director	Founder	Business	51-100	acquired	FinTech
G	Managing Director	Founder	Law	51-100	Series A (10M+)	LegalTech
H	Managing Director	Founder	Law	201-500	Series B (50M+)	FoodTech
I	Managing Director	Founder	Business	51-100	Series A (10M+)	FinTech
J	Managing Director	Founder	Business Engineering	11-20	Series A (n.a.)	Software
K	Managing Director	Founder	Business	1-10	n.a.	Ecommerce
L	Managing Director	Founder	Business	101-200	Series B (10M+)	PropTech

Table 1. The Studied Interviewees

7.4 Appendix D - Findings Overview

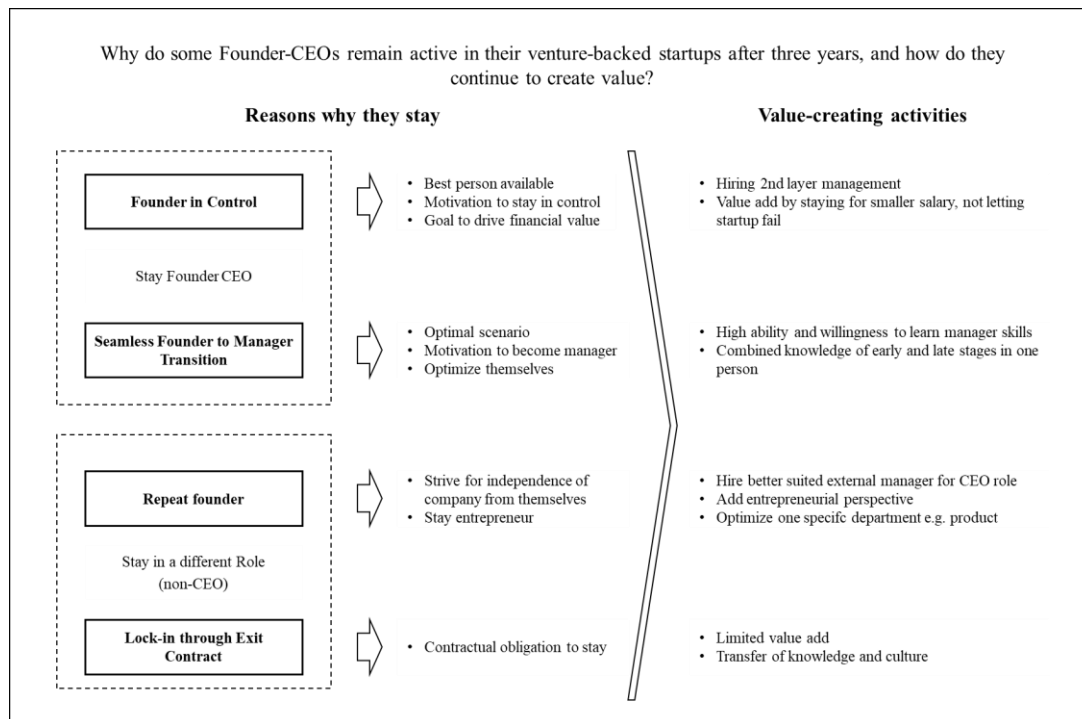


Figure 3. Findings Overview

7.5 Appendix E - Interview Guide

Short Introduction

1. Please briefly describe your education and career to date.
2. What is your current role?

Questions to Investors

1. Please briefly describe your VC fund & investment focus.
2. How much ownership (in %) do you typically strive for? Why?
3. Why and in which cases do you take a board seat?
4. How do you create value beyond the financial investment?

Questions to Founders

1. Please briefly describe the operational activity and current size of your start-up.

Motivation

2. Why did you start your company?
3. Do you think it is the best financial decision to start up?
4. How important is the founder for the business? And why?

Characteristics

5. How would you describe your character?
 - a. Which characteristics were especially important in the first year of starting your business?
 - b. Which characteristics are especially important during the growth phase?
6. Why did you decide to raise funds from external investors?
7. Why did you decide to give up ownership?
8. How did the VCs create value?
9. Do you think Founders are good Managers? Why?

Changing Skillset

10. What is your role, and what tasks do you perform?

11. How did your role and your tasks change from the beginning to today?
 - a. Why are you best suited for this role?
 - b. Why or why not are you considering bringing in an external CEO with the specific skillset needed today?
12. In which scenario would you leave the company?

Final Questions

1. What recommendations would you give founders to continuously create value in the company?
2. Which recommendations would you give to founders when is the time to leave the company?
3. Is there anything we haven't talked about that you think is important?

THANK YOU very much for taking part in my questionnaire!

7.6 Appendix F - Helpful Character Traits for Founders

The sweet spot for starting a new venture combines the founder's experience with the necessary naivety and optimism. High speed and iterating while being close to the customer are essential in entrepreneurship. The most important task is building a team by hiring people better than you. The overall goal is to build a stable organisation independent of yourself. Fundamentally helpful character traits and skills of entrepreneurs are to inspire and an emotionally positive attitude connected with the ability to sell their person and business. In addition, persistence and resilience are essential because an unwavering belief in things is necessary to overcome crises. This includes the ability to learn and the creativity to solve problems. As a founder, you need courage, a willingness to take risks, and a certain naivety to take on such a big challenge. In addition to the big strategic picture and vision, founders need the ability to delve into the operational details. Because of this particular mindset, prior experience, such as strategy consulting, has advantages

and disadvantages because the environment is high-performance and fast-paced, but no entrepreneurial thinking is trained.

“It is said that intelligent people are risk averse because they are better able to assess things and the resulting consequences. And in such entrepreneurial activities, it is important to find a balance. So if you are stupid, it will probably be difficult to be successful in the long term with certain business models because you are always in competition. On the other hand, you have to have the willingness and the strength to do irrational things that do not follow any rational risk assessment. But then to bet, so to speak, on the smaller chance but, the greater outcome, that is, I believe, an essential ability that you have to have.” (Interviewee B)

“Great ability to really persevere and not let a significant number of negative experiences drag you down every day, you have to deal with that, day in and day out.” (Interviewee F)

“Founders, so to speak, have to have the crucial ability to put together stronger teams than they are themselves and build organisations.” (Interviewee B)

“I play the piano really poorly. I cannot sing, I am terrible at painting. And building businesses is, for me, also a certain expression of creative development because you imagine what something could look like, and then you work on it, like a sculptor, so to speak, trying to create a work, and sometimes it breaks, and sometimes it works and then you optimise it. And this form of entrepreneurship for me is also an expression of creative development.” (Interviewee B)