Should You Sign "Entrepreneurial Prenup" With Your Co-Founders?

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"One thing is certain in business. You and everyone around you will make mistakes." Sir Richard Branson

As a founder, you were probably given contradicting advice regarding the future perspective of your business. On a spectrum, this advice ranges from "be optimistic"[i] to "be realistic when starting a business"[ii]. Aspects, where you should remain realistic, are levels of fairness in initial equity splitting; the possibility of co-founders conflict; or that you or your co-founder might want to leave the venture at a certain point in time[iii]. Research indicates that 2 in 3 ventures fail due to the co-founders' conflict and that 39% of founding teams experience a founder exit[iv]. In non-family ventures, having an "entrepreneurial prenup" with dynamic agreements such as buyout terms in readiness might reinforce the venture's performance over time despite these possible suboptimal aspects.

Equity splitting is one of the hardest decisions founders are faced with very early on. Not only are founders forced to evaluate past and future contributions; the future is inherently uncertain. Furthermore, the levels of how fair this split is perceived to be, influences team dynamics and consequently venture's performance. How can founders overcome these tensions? On one hand, we can find examples indicating that founders think about the external uncertainties related to their personal partnerships and the ways to manage them. For example[v], in 2007, Google co-founder Sergey Brin signed a prenuptial agreement with his then spouse, the use of which left Google and Brin's ownership in it without any disruption when they had divorced in 2015. On another hand, founders seem to "be optimistic" and are less inclined to give the same "realistic" considerations concerning their ownership with co-founders,and hesitate to sign an "entrepreneurial prenup" with their co-founders. Snap Inc.[vi] and Facebook[vii] are examples of other disruptions in cases of co-founders' conflict and consequent co-founders exit in the absence of clear founders' ownership agreement. While both of these ventures have weathered these challenges successfully, there are many other stories where this was not the case, for instance, ArsDigita, Sonar Media, and others. Based on this, the most common advice given to founders is that they should "be realistic" and sign "entrepreneurial prenup" with dynamic ownership agreements such as buyout terms, with their co-founders[viii ix].

More specifically, and similarly to the personal prenuptial agreements that Sergey Brin has signed, buyout terms predefine the future conditions under which founders can leave the venture at some point in the future. That should allow the venture to successfully weather the founders' divorces, similarly as Brin's divorce did not have a significant impact on Google. However is the common advice, to sign an "entrepreneurial prenup", always the best one?

Preliminary results of our study of 375 founding teams of young, high-potential ventures indicate that 1 in 2 founding teams follow this advice and have agreed upon the buyout terms at founding. In terms of performance, our study further suggests that in the first 5 years of venture's existence, these provisions will be more likely to positively reinforce the venture's performance over time when there is a suboptimal level of fairness within the founding team regarding the way founders have split their equity at the founding. We observe further that for family ventures the impact of these provisions is not only weaker but can be also detrimental to the venture's performance.

Hence, should you sign an "entrepreneurial prenup" with buyout terms with your co-founders? While the common advice is confirmatory, our study advises caution and not a careless following of this advice. Founders of non-family ventures should indeed sign them in cases where they believe that the way of how they have split their equity at founding was not at the optimal level of fairness. Our study suggests that in such a way the "entrepreneurial prenup" might help improve the venture's performance in the first years of venture's existence.

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[viii]https://hbr.org/2016/02/the-very-first-mistake-most-startup-founders-make

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