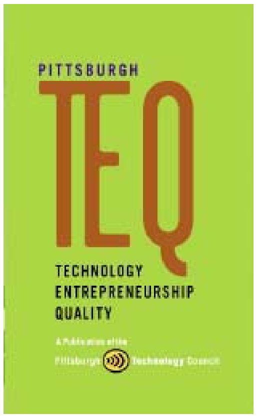

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Who Really Controls Your Company? Majority Stock Ownership Doesn't Ensure an Entrepreneur's Control

By Jack Roseman

A lot of entrepreneurs go into business not so much for the money as for the opportunity to run their own show. That was my motivation, and it is the motivation for most of the entrepreneurs I know. This permits us to do our own thing. Of course when you are completely free to do your own thing, a lot of the things you do will be dumb. But they're your dumb things-rather than the dumb things of some smug supervisor.

Let me give you an example. In my first company, I told my partner I wanted to give everybody who came to work for us one percent of the stock of the company. That was my ideal for a business-totally invested and all of us working for the same goal. It was a crazy idea, but my idea and the only way I was able to even think about doing something so unconventional was by running my own show.

Of course, my partner pointed out to me that we would run into a problem with employee 101-and we never did it. But we did a lot of other Roseman kind of things that wouldn't have been possible if I hadn't had control of my company.

Control usually doesn't become an issue until you go outside the family for money. And when you do, you will find that different types of investors have greater or lesser tolerance for letting you run your own show. After family, friends, savings, and credit cards, most first-time entrepreneurs try to tap private investors, so-called "angels." These are high net worth individuals who may or may not require a hand in day-to-day operations. Typically, they require less control over operations than a venture capitalist and that's what I wanted. I was already working for someone and there was no way I was going to start my own company and then have people telling me day by day what I was going to do.

It took some time to find somebody willing to give me majority stock ownership, but when I did, it was the best investor deal I ever struck. It was an angel deal-I was majority owner and though I had to give away 40 percent of the company, my investor was happy to let me run the show. What I didn't realize at the time was that is not always the case.

Like a lot of entrepreneurs, I thought control meant majority voting rights. But in truth, stock ownership is really more of an economic deviser than the determinant of who runs the company. Control of the company is really vested in something called a term sheet.

When you go for venture capital, the venture capital people may want 15-20 percent of the company, and the entrepreneur may take comfort in that, thinking, certainly they don't have control. But any kind of professional investing arrangement will include a term sheet and the term sheet describes the stuff that the VC must sign off on before the entrepreneur can do it. For instance, the term sheet may say things like: you will not take or borrow money without our approval; you will not buy capital equipment without our approval; you will not give any officers a raise without our approval; you will not declare dividends without our approval; and so on.

Term sheets can have little tolerance for dumb management mistakes, and no appreciation for an entrepreneur's fun factor.

Of course, if I was the venture capitalist and I was handing over $2 million, I would want those provisos too. But I'm not, though I have some very good friends who are. Rather, I am the entrepreneur, and the driving reason I'm taking the risk of starting a new business is that I don't want to be working for someone else. I want some freedom. I don't want to be second-guessed in my decision-making.

So if control is important to you, be aware of the term sheet. Because if a venture capitalist only took one point, but stuck in all those provisos, I would argue that from one point of view, that one- percent controls you. My advice to any entrepreneur based on what I have learned for myself is that when someone says, "I want control," I say, "Would you mind defining what you mean by control."

Jack Roseman is the Director of The Roseman Institute. He was the founder of two successful computer firms and was president of a third, On-Line Systems. Jack formerly was the associate director of the Donald H. Jones Center for Entrepreneurship at Carnegie Mellon University's Graduate School of Industrial Administration (GSIA). This column was written with Steven N. Czetli, former Executive Editor of T.E.Q.