§1 Introduction

Not surprisingly, there are differences of opinion regarding the definition of organizational culture and how it develops. Schein offers one useful definition of the term by declaring that “[o]rganizational culture . . . is the pattern of basic assumptions that a given group has invented, discovered, or developed in learning to cope with its problems of external adaptation and internal integration—a pattern of assumptions that has worked well enough to be considered valid and, therefore, to be taught to new members as the correct way to perceive, think, and feel in relation to those problems”.¹

Schein has noted that the founders of an organization not only create the group but also launch the process of defining and shaping the group’s “organizational culture” through the force of their own personalities and by applying their own theories about how the organization can be successful based on their own previous experiences in the cultures in which they grew up.² Schein cautions that while founders may prepare and disseminate formal “charters” that describe their preferred philosophy or value system, the actual organizational culture is the assumptions that underlie the values and which have been embraced by the organizational members in a way that determines acceptable behaviors by those members. In other words, while the assumptions and theories that the founders to bring to the group are important they will be tested by the actual experiences of the group before they are ultimately accepted as part of the organizational culture.³

§2 Role of founders in creating organizational culture

The role of the founders with respect to creating the organizational culture can be understood by following the “typical” progression of the firm as suggested by Schein. The first step, of course, is the identification of an idea for a new enterprise by a single person—the “founder”. While the founder could presumably act on his or her idea without the help of others, what generally happens is that others are brought into what becomes a “founding group” that operates based on a consensus that the idea is viable and worth pursuing even in the fact of known and unknown risks and uncertainties. The founding group begins to take the necessary steps to launch and organize the firm, including obtaining capital, forming a business entity (e.g., a corporation), preparing and

³ Id. (“The ultimate organizational culture will always reflect the complex interaction between (1) the assumptions and theories that founders bring to the group initially and (2) what the group learns subsequently from its own experiences.”).
filing patent applications and other things. As the launch process unfolds and resources become available the founding group brings other necessary parties into the process, including employees and external advisors and business partners, and the group begins to cope with its problems of external adaptation and internal integration and gather the information necessary to settle upon an organizational culture.\textsuperscript{4}

While the actual experiences of the group in coping with external adaptation and internal integration will determine which values and assumptions are accepted as part of the group’s organizational culture, Schein had no doubt that the founder will have a strong influence for several reasons. First of all, the initial idea for the enterprise will almost certainly be accompanied by strong views about how the idea can be fulfilled and those views will be a byproduct of the founder’s personality and his or her previous experiences in other cultural contexts. Second, the founders observed by Schein were generally quite strong-minded about what should be done and how it should be done and this included “strong assumptions about the nature of the world, the role their organization will play in the world, the nature of human nature, truth, relationships, time, and space”. In other words, founders bring to their role of organizational leader a distinct and pre-determined “view of the world”. Finally, the founder, in his or her role as the president or other titular leader of the group during the formation process, will necessarily have a strong influence on the strategies that are used to address the firm’s initial set of external survival and internal integration problems.\textsuperscript{5}

\section*{§3 Founders’ methods for embedding preferred cultural elements}

Schein noted that in order for the founder to be successful in injecting his or her preferred values and assumptions into the organizational culture he or she must first determine the best way to “teach” those values and assumptions to other members of the group. Once the teaching process has been perfected group members can express their views as to whether or not those values and assumptions will work in overcoming the problems—external and internal—threatening the survival of the group. Schein suggested the following list of “mechanisms” that founders and other key organizational leaders can use to “embed” their preferred cultural elements within the group:\textsuperscript{6}

\begin{enumerate}
\item Formal statements of organizational philosophy, charters, creeds, materials used for recruitment and selection, and socialization.
\item Design of physical spaces, facades, and buildings.
\item Deliberate role modeling, teaching, and coaching by leaders.
\item Explicit reward and status system and promotion criteria.
\item Stories, legends, myths, and parables about key people and events.
\item What leaders pay attention to, measure, and control.
\end{enumerate}

\begin{thebibliography}{9}
\bibitem{id} Id. at 352.
\bibitem{id} Id.
\bibitem{id} Id. at 355 (Figure 3).
\end{thebibliography}
7. Leader reactions to critical incidents and organizational crises (times when organizational survival is threatened, norms are unclear or are challenged, insubordination occurs, threatening or meaningless events occur, and so forth).
8. How the organization is designed and structured. (The design of work, who reports to whom, degree of decentralization, functional or other criteria for differentiation, and mechanisms used for integration carry implicit messages of what leaders assume and value.)
9. Organizational systems and procedures. (The types of information, control, and decision support systems in terms of categories of information, time cycles, who gets what information, and when and how performance appraisal and other review processes are conducted carry implicit messages of what leaders assume and value.)
10. Criteria used for recruitment, selection, promotion, leveling off, retirement, and "excommunication" of people (the implicit and possibly unconscious criteria that leaders use to determine who "fits" and who doesn't "fit" membership roles and key slots in the organization).

Schein listed the mechanisms from more or less explicit ones to more or less implicit ones and noted that the mechanisms will vary in terms of potency and effectiveness. Further complications arise from the fact that the mechanisms often are in conflict with one another, as well as the fact that different sub-groups within the organization may have different assumptions about the way that the world should be viewed. Finally, as noted above, the process of "embedding" calls for teaching skills and tools and founders do not always do the best job of clearly conveying their meaning and may often unwittingly communicate implicit messages that they are not even aware of.7

§4 Stanford Project study of influence of founders on organizational culture

An interesting study of organizational culture among early-stage technology companies in the Silicon Valley was undertaken by the Stanford Project on Emerging Companies ("SPEC").8 Among other things the researchers were interested in how the founders of those companies addressed key organizational design issues during the start-up period. The SPEC was concerned not only with the actions taken, and decisions made, as these companies were launched and began to grow but also wanted to learn more about the long-term impact of those actions and decisions on the company as it continued forward and became larger and more mature. The researchers postulated that in order for a company to be successful it was necessary to develop and institutionalize coherent blueprints for the relationship between the company and its employees that fostered reliability and accountability. They believed that the choices made by companies with respect to definition and adoption of their relational blueprint, which is an important element of their organizational culture, would be heavily influenced by the beliefs of the

7 Id. at 356-357.
8 The discussion below is based on “Entrepreneurship: Lessons from the Stanford Project on Emerging Companies”, Stanford Graduate School of Business (September 3, 2003) (hereinafter “SPEC (2003)”). Further information on the SPEC is available on the SPEC website (http://www-gsb.standord.edu/SPEC).
founders of those companies (and any non-founder CEO) regarding how work flow within the company and the employment relationship should be structured.

§5   --Dimensions for creation of organizational blueprint

Based on extensive interviews of the founders and, where applicable, non-founder CEOs of the companies in their study group the researchers identified what they considered to be three crucial dimensions that could be used to describe and categorize how companies created a blueprint during the start-up period for creating and maintaining a relationship with their employees that fostered reliability and accountability: the basis of attachment to and retention by the company; the organizational structure, as determined by the means selected to attempt to coordinate and control employee activities; and the criterion used for selecting persons to join the workforce. Information from the founders and non-founder CEOs was considered crucial because the choices made by companies with respect to definition and adoption of their relational blueprint is heavily influenced by the beliefs of these key leaders regarding how work flow within the company and the employment relationship should be structured..

The first dimension, “attachment,” refers to the basis for the bond, or relationship, formed between a company and its employees. The SPEC researchers described three different bases for attachment—love, work and money. Founders and CEOs wishing to rely on “love” did so by attempting to create and maintain a feeling of community and “family” within the workplace and thus forge strong emotional bonds within the workforce that would motivate employees and make them want to remain with the company. On the other hand, when attachment was based on “work” the focus was on appealing to the desire of knowledge workers to be part of an organization that provided opportunities for interesting and challenging work on cutting-edge technologies and for personal and professional development. In this type of environment, the primary loyalty of employees was to a specific project as opposed to the company, a supervisor or other co-workers. Finally, companies where the attachment was based on “money” tended to be those where both sides looked at the employment relationship simply as an exchange of labor for money without the additional emotional connection and/or intellectual challenge associated with the other forms of attachment.

The second dimension—organizational structure—is largely determined by the initial choices made by the founders and CEOs regarding the principal means used to coordinate and control the flow of work within the company. SPEC researchers found that the most commonly used method relied heavily on informal controls through peer pressure and, eventually, organizational culture; however, at least three other approaches were also identified. First, some companies relied on “professional control,” which was grounded in the assumption that employees were professionally socialized to diligently perform outstanding work based on their formal education and training. Employees in these companies, which tended to have a recruiting preference for high-potential individuals

9 Id. at 3-4.
10 Id. at 4.
from elite institutions, were given significant autonomy and independence. Second, some companies chose to implement formal procedures and systems to control employees. Finally, some founders and CEOs preferred to directly oversee the activities of their employees to control and coordinate the work flow within the company.¹¹

The third and final dimension is the method used by founders and CEOs to select employees and the underlying assumption is that these company leaders will have a relatively high involvement in recruitment and selection of managers and employees at least while the size of the company remains small and they are likely to have regular direct contact with most of the employees. Once again, several distinct alternatives were identified in the course of the research. Not surprisingly, one of the popular approaches was to staff the company based on the evidence of skills and experience required in order to complete one or more of the tasks or activities that might be of immediate importance to the success of the company. This alternative is noteworthy because of its emphasis on the immediate, or short-term, needs of the company. Because start-ups often have less time and money than they really want or need it is essential that limited resources be invested in employees who can contribute right away and get up to speed quickly and easily without slowing down the process of developing new products or technologies. Companies that looked to grow and develop through completion of a series of projects tended to be more interested in indications of long-term potential of new employees and their apparent aptitude for easily transitioning to new and increasingly challenging projects over time. Finally, some companies, which obviously interested in the skills and experience of prospective employees, tended to place the greatest weight on how well the candidate would apparently fit into the culture of the company and relate to co-workers.¹²

§6 --Models of employment relations

After the SPEC had researchers identified the three types of attachment and selection and the four types of control present within the companies in the study group they moved on to study the relationships among the three dimensions in order to construct various alternative models for employment relations, a strong proxy for organizational culture, which could then be evaluated and tested on other measures. Based on how the choices made by the various companies were clustered the researchers came up with five basic models of employment relations referred to as engineering, star, commitment, bureaucracy and autocracy.¹³

The dominant types on the three key dimensions for the “engineering” model were challenging work, peer group control, and selection based on the ability to perform specific tasks. The engineering model conforms closely to the standard descriptions of the basic Silicon Valley model and was, in fact, the most common model among the SPEC study group. Companies formed on the “engineering” evidenced a strong commitment to the project-at-hand, if not the company itself as was the case with the

¹¹ Id. at 4-5.
¹² Id. at 5.
¹³ Id. at 5-6.
“commitment” model. Employees were attracted to these types of companies by the need to work on closely-knit teams dedicated to resolution of difficult and challenging problems. Employees were performance driven and achievement oriented and able and willing to work on interdisciplinary teams that were formed for a particular project and then disbanded when work on the project was completed. These companies tended to have a high level of customer focus when selecting their projects. Accordingly, as customer preferences changed the selection criterion for employees had to be modified also in order to ensure that the available personnel were qualified for the current tasks.14

The dominant types on the three key dimensions for the “star” model were challenging work, professional control, and selection based on long-term potential. The star model aligns closely with the way in which research work is conducted in academia and it is not surprising that this model was by far the most popular with those companies that were engaged in medical technology and research, including biotechnology. Only a very small percentage of the companies that were active in other industrial sectors chose the star model. Recruiting policies and strategies at companies following the “star” model focused on identifying candidates with the highest level of talent and accomplishment, paying them top wages and providing them with the autonomy and resources that they needed in order to accomplish their immediate goals and continue to develop as experts in their fields. For founders the challenge was to establish and maintain an exciting environment and find a way to balance their need for control against the autonomy demanded by talented employees attracted to that particular employment model.15

The dominant types on the three key dimensions for the “commitment” model were emotional and familial links between the company and its employees (i.e., “love”), peer group control, and selection based on cultural fit. Anecdotally, the most well-known and celebrated example of the commitment model within Silicon Valley has been the early years of Hewlett Packard. It was common for the founders of companies based on the “commitment” model to speak of their personal involvement in the simplest aspects of the company and its relations with employees including personal visits with employees on a regular basis and down-to-earth involvement in company events. For these founders the goal was to encourage lifetime employment and commitment to the company, its missions and the people who worked there.16

The dominant types on the three key dimensions for the “bureaucracy” model were challenging work, formalized control, and selection based on the ability to perform specific tasks. Not surprisingly, these “bureaucratic” companies based their operations on specific procedures, methodologies and systems and the founders and human resources managers invested a significant amount of time and effort in creating documentation including job and product descriptions. Formal and rigorous project

14 Id. at 6.
15 Id. at 6-7.
16 Id.
management systems and tools were also a hallmark of companies using the “bureaucracy” model.\textsuperscript{17}

The dominant types on the three key dimensions for the “autocracy” model were exchange of labor for money, control through personal oversight, and selection based on the ability to perform specific tasks. Not surprisingly, founders depending on the “autocracy” model tended to have little skill with, or patience for, slow and deliberative consensus management techniques. While founders believed that employees communicated well, there was little time for the warm and fuzzy interactions associated with the commitment model and there was little delegation of authority or doubt in the minds of employees as to who would be making the final decisions on key issues.\textsuperscript{18} Like the “bureaucracy” model, autocratic founders did not invest a lot of time in interactions with employees, relied on formalized controls to guide day-to-day activities and tended not to delegate substantial amounts of authority with respect to key decisions relating to the company.\textsuperscript{19}

Several observations can be made regarding the five basic models. First, the “commitment” model is unique because it is the only that relies heavily on “love” and forging a sense of community among the employees as the basis for creating and maintaining a relationship between the employees and the company. Second, the “autocracy” model is unique for other reasons given that it is alone in its preferences with regard to attachment (“money”) and coordination and control (i.e., direct monitoring). Third, quality of work and skills were the most popular choices for attachment and selection, respectively. Finally, the “engineering” and “bureaucracy” models were the closest of the five basic models differing only with respect to their approach to coordination and control (i.e., peer and/or cultural control for engineering-type companies and formal processes and procedures for bureaucracy-type companies).\textsuperscript{20}

Obviously not all of the companies in the SPEC study conformed exactly to one of the basic models. The SPEC researchers identified a number of “near-model” types, which were cases where companies differed from one (and only one) of the basic models on only one dimension. For example, a founder might attempt to base attachment on love, exercise control through personal oversight, and select employees based on cultural fit. This combination was very close to the “commitment” model, with the only difference being the basis upon which control was exercised over employees. Also, while the researchers were confident about the value of identifying the various basic models they also acknowledged that some companies followed what was referred to as a “non-type” blueprint because they differed from two or more basic model types on one dimension or differed along two or more dimensions from every basic model type.\textsuperscript{21}

\textsection{7} Factors influencing selection of employment relations model

\begin{itemize}
  \item \textsuperscript{17} Id. at 6.
  \item \textsuperscript{18} Id. at 11.
  \item \textsuperscript{19} Id. at 13-15.
  \item \textsuperscript{20} Id. at 42.
  \item \textsuperscript{21} Id. at 6-7.
\end{itemize}
Of the models discussed above, the most common among the study group was the engineering model; however, one of the most striking features of the results of the SPEC study is the remarkable diversity among the companies in spite of their common roots within the mythical Silicon Valley culture and the related business and social network. A number of theories on organizational development argue against the high level of diversity found among the companies in the SPEC study group. For example, neo-institutionalists that have studied the development and growth of Silicon Valley have predicted that companies will adopt specific corporate structures and practices because of the profound influence of venture capitalists, human resource professionals, and the law and accounting firms that advise those companies. While the SPEC researchers concede that companies receiving venture capital are more likely to bureaucratize more often and at an earlier stage, in general the companies that have been supported by venture capitalists in the study group evidenced substantial diversity in the organizational blueprints. This does not necessarily mean that venture capitalists did not have any influence upon the strategies and structures selected by their portfolio companies. In fact, many venture capitalists, in an attempt to differentiate themselves in what is often a very competitive marketplace where investors fight to get into promising new deals, are well known for their preferences for certain corporate cultures. One can identify venture capitalists that prefer to be associated with companies that are being built to survive based on long-term emotional ties, similar to the “commitment” model, while others are more interested in “Star” cultures or companies that value technological excellence and structure their organizations and selection processes accordingly.

Interestingly the SPEC researchers did not find any consistent correlation between the employment models selected by the founders and the founders’ own professional background working within other organizations. For example, while there were founders within the sample group who came from bureaucratic organizations and chose to adopt a bureaucratic template there were also a similar number of founders coming from the same background who specifically rejected bureaucracy as dysfunctional and expressed a keen desire to embrace a completely different culture and operating style for their new companies. On the other hand, however, there did appear to be a link between the organizational blueprint selected and the founder’s initial business strategy. The companies in the SPEC study group generally chose one of five specific business strategies—radical innovation (49%); technology enhancement (20%); sales, marketing or service (14%); cost minimization (7%); or a hybrid (10%). Companies that selected radical innovation tended to select either the ‘star’ or “engineering” models. Companies that selected technology enhancement tended to select the “star”, “engineering”, or

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24 Id. at 9-10.
25 Id. at 10.
“bureaucracy” models. Companies that selected sales, marketing or service preferred the “commitment,” “engineering,” or “bureaucracy” models. Finally, companies that selected cost minimization preferred either the “engineering” or “autocracy” models.

While one could find engineering companies that tried to compete through each of the four main business strategies, companies following the commitment model tended to limit their business strategy to sales, marketing or service, a path that was consistent with the emphasis of those types of companies on establishing close long-term relationships between the company and its employees which, in turn, could support the strategic objective of strong long-term relationships between those committed employees and the company’s key customers. Similarly, “autocratic” companies limited their business strategy to cost minimization. This data is consistent with the view of many commentators that strategy is an important factor in organizational design generally and specifically in selecting the appropriate form of organizational culture.

§8  --Impact of initial employment relations model on firm evolution

The SPEC researchers claimed that the results of their study provided evidence that the choices made by the founders with respect to the initial employment blueprint did have a strong impact on the evolution of the company and that attempts to significantly alter the blueprint as the company mature would likely have a substantial destabilizing effect. A little over half of the companies in the SPEC study group made no changes in their organizational blueprint as they evolved while another 30% changed on just one dimension, usually to control coordination. About 15% of the companies attempted to change from one of the pure model types to another, although almost three-quarters of these changes were between the closely related “engineering” and “bureaucracy” models. The researchers tested differences between the preferences of the founders and the non-founder CEO’s who were more likely to come on board a significant amount of time after the founders have launched the company and the original employment blueprint was selected and applied. The key findings appear to be that the star and engineering models were more popular with founders than with the CEO group and that the CEO group was more likely than the founder group to prefer the bureaucracy model. However, in general, the founder’s views regarding the appropriate level of self-management were generally so well engrained during the start-up phase that later attempts by a new CEO to introduce more formal bureaucratic procedures were typically not very successful and were often dangerously destabilizing to the business.

Companies that adopted the commitment model took on lower levels of administrative overhead as they developed and matured, were more likely to go public, relative to

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26 Id. at 11-12.
27 Id. at 12-13.
28 Id. at 44.
29 Id. at 13.
comparable companies that selected different models; and were also the least likely to “fail,” which included declaring bankruptcy, being acquiring on unfavorable terms or simply shutting the doors and disappearing without a formal closure.\textsuperscript{31} Companies that selected the star model were least likely to go public; however, star model companies that did go public enjoyed the highest levels of stock market performance once the IPO was completed. Star model companies fared second best, behind the commitment model companies, in their ability to avoid failure.\textsuperscript{32} Companies that selected the autocratic model were most likely to fail and if they were able to survive and complete an IPO they turned in the worst post-IPO stock market performance. The second worst performance came from those companies that had no clear model. It should be noted, however, that apart from the striking strengths of the commitment model with respect to completing an IPO and avoiding failure, the differences among the other models were not that significant.\textsuperscript{33} In general, the two most unattractive models for Silicon Valley-based companies were the “bureaucratic” and “autocratic” blueprints.

As noted above, material changes in the initial organizational blueprint were relatively uncommon among the companies in the SPEC study group; however, the researchers nonetheless attempt to assess and understand the relationship between attempts to change the organizational culture and “destabilization”, which can take a variety of different forms including erosion of skills and talents due to turnover, sudden and extreme alterations in the bases of power and status within the company; undermining of cherished belief systems; confusion in the minds of outsiders, such as customers, investors and other business partners, about the identity and purposes of the company; and damage to the reputation of the company.\textsuperscript{34} They found that companies that significantly changed their employment blueprint after the start-up stage were much more likely to fail and if those companies had completed an IPO before the change they could expect to experience a substantial decrease in their market value following the change.\textsuperscript{35} There was a strong positive correlation between changes in the initial employment blueprint and employee turnover, particularly turnover among the more senior employees.\textsuperscript{36} Not surprisingly, the higher the level of turnover the more adverse impact there was on subsequent growth in the revenues of the company. When changes were made to the initial employment blueprint a change to the engineering model was generally the least disruptive. In general, however, changing the model typically reduced the likelihood of a successful IPO by 50%, tripled the likelihood of failure, and triggered rapid deterioration in subsequent growth of the market capitalization of the company.

\textsuperscript{31} Id. at 14-15 (citing M. Hannan, J. Baron, G. Hsu and O. Kocak., “Staying the Course: Early Organization Building and the Success of High-Technology Firms.” Unpublished Manuscript, Graduate School of Business, Stanford University).

\textsuperscript{32} Id.

\textsuperscript{33} Id. at 15.

\textsuperscript{34} Id. at 13.

\textsuperscript{35} Id. at 16 (citing M. Hannan, J. Baron, G. Hsu and O. Kocak, “Staying the Course: Early Organization Building and the Success of High-Technology Firms.” Unpublished Manuscript, Graduate School of Business, Stanford University).

\textsuperscript{36} Id. at 13 (citing J. Baron, M. Hannan and M. Burton, “Labor Pains: Organizational Change and Employee Turnover in Young, High-Tech Firms,” American Journal of Sociology 106:960-1012).
§9 Founders’ influence on organizational design

Organizational development has been widely and intensely studied and researchers have been particularly interested in how external and internal contingencies confronting organizations as they grow and mature influence organizational design, particularly the level of bureaucratization. Several researchers have observed that the amount, form and timing of bureaucratization as organizations develop and mature is significantly impacted by the circumstances surrounding the founding of the organization, particularly the influences of the founders, and the “embedded” social relationships that took hold among the original members of the organization. In addition, Weber, the most prominent student of “bureaucracy”, argued that preexisting foundations of authority, which are often established and nurtured by the founders and their followers (e.g., charismatic, traditional or rational-legal), and social and economic context are two significant factors in predicting the form and character of bureaucratic institutions.

Baron et al. used data collected from the companies in the SPEC study group to analyze the influence of founders on several facets of “bureaucratization”, specifically managerial intensity, the formalization of employment policies and relationships and the proliferation of specialized managerial and administrative roles and titles. In selecting their areas of study, the researchers noted that they focused on several attributes of bureaucratization that scholars had previously identified as “defining aspects of the bureaucratic form”, including the following elements: formal definition (and increasing specialization) of fixed and official jurisdictional areas; reliance on hierarchical authority vested in formal roles; formalization and documentation of rules; selection of personnel based on qualifications; employment viewed as a career and governed by explicit and well-documented rules and procedures; and the emergence of management and administration

37 For detailed discussion of organizational design, see “Organizational Design” in “Entrepreneurship: A Library of Resources for Sustainable Entrepreneurs” and “Organizational Design: A Library of Resources for Sustainable Entrepreneurs”, both prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).
as a “role”, conducted full-time as a professional vocation, which is discharged universalistically and dispassionately.\textsuperscript{41} The researchers concluded that the organizational models that arose under the influence of the founders, as well as the social composition of the labor force at the time of founding, had a significant impact on the growth in managerial intensity among the firms, an impact that endured even after the initial founders were no longer with the firm.\textsuperscript{42} However, the researchers found less evidence of founder influence on the formalization of employment policies and relationships and the proliferation of specialized management titles. In fact, they argued that these “superficial aspects of bureaucracy” were eventually adopted as a result of normal organizational growth and maturity and to satisfy “external gatekeepers”, such as venture capitalists, analysts and institutional investors.\textsuperscript{43}

Managerial intensity refers to the degree to which an organization depends on managerial and administrative specialists and follows Scott’s definition of bureaucracy “as the existence of a specialized administrative staff”.\textsuperscript{44} Baron et al. measured the “prevalence of specialized managerial and administrative functions and personnel” by looking at the number of full-time equivalent managerial and administrative specialists employed by firms in their study group.\textsuperscript{45} They found, as expected, that firms founded on the basis of a bureaucratic model had the highest level of managerial intensity while firms with founders that followed the commitment model (i.e., relying on implicit and informal controls and alignment of the interests of the firm and its workers through long-term attachments) exhibited much lower levels of administrative intensity.\textsuperscript{46} As an aside, Baron et al. commented that the relatively low reliance on specialized managerial and administrative functions and personnel among “commitment” firms did not necessary mean that the founder had abandoned efforts at coordination and control and that

\textsuperscript{41} Id. at 3 (citing Max Weber’s list of several of the quintessential elements of “bureaucracy” described in W. Scott, Organizations: Rational, Natural and Open Systems (3rd Ed) (Englewood Cliffs, NJ: Prentice Hall, 1992), 40-41).
\textsuperscript{42} Id. at 1 and 3-4. Baron et al. noted that these findings were consistent with the observations of other researchers who had observed that the amount, form and timing of bureaucratization as organizations develop and mature is significantly impacted by the circumstances surrounding the founding of the organization, particularly the influences of the founders, and the “embedded” social relationships that took hold among the original members of the organization. See, e.g., W. Boeker, “Organizational Origins: Entrepreneurial and Environmental Imprinting at the Time of founding”, in G. Carroll (Ed.), Ecological Models of Organizations (Cambridge, MA: Ballinger, 1988), 33-51; and M. Granovetter, “Economic Action and Social Structure: the Problem of Embeddedness”, American Journal of Sociology, 91 (1985), 481-510).
\textsuperscript{43} Id.
\textsuperscript{44} W. Scott, Organizations: Rational, Natural and Open Systems (3rd Ed) (Englewood Cliffs, NJ: Prentice Hall, 1992), 40.
\textsuperscript{46} Id. at 3 and 10. See also R. Walton, “From control to Commitment in the Workplace”, Harvard Business Review, 63(2) (1985), 76-84 (arguing that organizations structured along clan or commitment lines can reduce the amount of bureaucratic overhead).
oversight and monitoring may have come in any forms such as reliance on budgets, information systems or other similar types of controls.\textsuperscript{47}

Evidence was also found that the proportional representation of women among the firm workforce at the end of the first year of operations had a statistically significant negative effect on managerial-administrative intensity.\textsuperscript{48} The researchers found that the average percentage of women included in the senior management team was 14\% and that senior women were typically toiling in human resources and administration and much less likely to be found overseeing engineering or research and development activities.\textsuperscript{49} When the spotlight was placed on the top of the organizational hierarchy the researchers found that only about 10\% of the studied companies had a woman occupying the role of CEO, president or founder. Gender diversity at the top of the organizational hierarchy did have an impact on hiring policies for other roles within the company as the researchers found that when there was a woman at the top of the pyramid the company, or leading the engineering or research and development functions, it was much more likely that the company would have more women in scientific and technical positions.

Formalization of employment policies and relationships was measured analyzing the level and timing of adoption of various employment practices, policies, forms and documents directed at formalization of some aspect of the employment relationship. Specifically, the person most knowledge about human resources matters at each firm was surveyed about which of the following items had been adopted by the end of the first year of firm operations and by the time the researchers made their first visit to the firm: organization chart; standardized employment application; written job descriptions; personnel manual or handbook; written employment tests; written performance evaluations; standard performance evaluation forms; written affirmative action plans; standard employment contract for exempt employees; employee grievance or complaint forms; and human resources information system. While the researchers found that firms had, on average, adopted few, if any, of the aforementioned items by the end of their first year, by the time that the survey team visited firms had, on average, adopted between six and seven of the practices.\textsuperscript{50} Baron et al. concluded that “[o]n balance . . . we find less evidence of enduring effects of founders’ models on the extent or pace of employment formalization than we did on the evolution of managerial-administrative intensity”.\textsuperscript{51} They noted that in the this area it was not a question of whether technology firms would adopt formal human resources practices but how fast would they do it and pointed out that receipt of venture capital investment tended to accelerate the adoption process.

\textsuperscript{47} Id. at 10 (footnote 9).
\textsuperscript{48} Id. at 3 and 13.
\textsuperscript{50} J. Baron, M. Burton and M. Hannan, “Engineering Bureaucracy: The Genesis of Formal Policies, Positions and Structures in High-Technology Firms”, The Journal of Law, Economics and Organization, 15 (1999), 1-41, 16. Interestingly, 64\% of the firms had not adopted any of the employment practices during their first year and only 23\% adopted more than one of the practices during their first year. Id.
\textsuperscript{51} Id. at 23.
Formalization and specialization of top management roles was measured by looking at the extent to which the following positions had been created in the firm’s organizational hierarchy by the end of the first year of firm operations and by the time the researchers made their first visit to the firm: President; Chief Executive Officer; Chief Operating Officer; Chief Financial Officer’ Chief Technical Officer; Chief Information Officer; Vice President, Engineering (R&D, Technology); Vice President, Sales; Vice President, Marketing; Vice President, Customer Support/Service; Vice President, Operations (Manufacturing, Production); Vice President, Finance; Vice President, Administration; Vice President, Human Resources; Vice President, Strategic Planning (Business Development); and/or “Senior” or “Executive” titles in any of the vice presidential areas.\(^5^2\) The researchers found a relatively weak relationship between founding conditions and formalization and specialization of top management roles and commented that increases in the proliferation of management titles was more strongly driven by factors such as employment growth, venture capital funding and going public.\(^5^3\)

§10 Founders’ networks

It has long been contended that in order for organizations to form and prosper the organization must have access to sufficient resources of wealth, power and legitimacy.\(^5^4\) Since a new organization does not have its own network, this means that during its initial organizational stages it is heavily, if not exclusively, dependent on the then-existing social networks of the organizational founders and the efforts of those founders to tap into those networks and expand them in ways that can help support the launch of the organization.\(^5^5\) Powell and Porter described these social networks as consisting of “relational ties that foster the flow of a wide variety of resources among individuals” and which “enable individuals to engage in activities that would be much more difficult (if not impossible) if they were not socially connected to the person with whom they were interacting”\(^5^6\).

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\(^5^2\) Id. at 24 (also describing how the researchers handled categorization issues such as different titles and persons holding multiple titles).

\(^5^3\) Id. at 28. The researchers noted that this was consistent with arguments of other researchers that development of bureaucratic organizational characteristics accelerates with the introduction of outside stakeholders, such as venture capitalists and institutional investors, in order for the firm to appear credible in the eyes of those stakeholders. The survey included evidence that firms often created specialized roles among their top management group prior to going public in an effort to flesh out and highlight specialized expertise that would be favorably received by investors.


\(^5^6\) Id.
The importance of social networks and the resources they can provide to new organizations has been validated by various studies. For example, according to Reynolds and Miller, the start-up process for launching a new business can begin with any of four key events—commitment, first financing, first hire or first sale—and will be finished when and if each of those four events have been successfully completed. Among a group of more than 3,000 organizations surveyed by Reynolds and Moore, 85% of the respondents reported that commitment was the first event for them, an activity that included gathering information and resources and identifying potential customers and suppliers. Researchers have also found that among high growth firms that successfully completed an initial public offering ("IPO"), those with extensive social resources, as measured by the companies’ business networks, personal networks and number of underwriters subscribed to the IPO, were more successful in accumulating financial capital in the years leading up to their IPO than those firms who had fewer social resources. In addition, studies have provided support for the proposition that science-based start-ups in the biotechnology sector have benefitted from early access to support and resources available from a diverse portfolio of highly central organizations.

The primary reason that entrepreneurs contact others during the launch stage for their new businesses is to gain support and test their business ideas. In most cases, entrepreneurs will turn first to their family and friends for advice; however, there is evidence that during the launch stage the development and maintenance of social contacts, and where entrepreneurs invest the most time and effort in seeking advice and information, varies depending on the specific phase of organizational development. A study of how entrepreneurs in four countries developed their contacts found the same pattern in each country: entrepreneurs generally limited the size of their discussion networks when they were involved in developing the initial motivation necessary to support a decision to move forward with launching a new venture; the size of their networks, and the time spent attempting to connect with others, expanded during the planning stage for the new venture; and the size of the network contracted, as did the time spend on working the network, as the entrepreneurs shifted their attention and energies toward actually establishing the new venture.

While informal networks are important to entrepreneurs during the launch stage, it is clear that many entrepreneurs also seek advice, information and other support from more
formal role models, particularly potential sources of financial capital. Much attention has been paid to the role of “angel investors”, who have been cited as being not only sources of seed capital but also as mentors who have been through the launch process and can provide entrepreneurs with access to a larger pool of potential resource providers and advice on how to be more effective in their entrepreneurial actions. In fact, one survey of angel investors in the US found that more than half of them had provided one or more types of non-financial support to the entrepreneurs they had backed including involvement in creating or reshaping the business concept, helping recruit additional managers or members of the management team and finding additional sources of financial capital. Only one in five of the angel investors helped their entrepreneurs with expanding their networks of personal and/or professional advisors or identifying prospective customers or suppliers. Some studies of venture capitalists suggest that they play a similar role in “professionalizing” new ventures; however, rather than mentoring founders who may have more technical than managerial experience venture capitalists “contribute” by pushing to bring in outsiders to fill in an experienced management team. Attorneys specializing in providing legal guidance to startups have been another source of formal mentoring for entrepreneurs and have been able to provide them with information on the most effective path to forming and organizing a new company.

§11 Founders/owners versus professional managers

The fundamental assumptions of the founder create the foundation for the distinctive characteristics or biases of the organizational culture of the company that tend to persist for as long as the company is run by the founder and/or his or her family members. These biases are highly valued by the first generation employees of the business since they are associated with the early success and ongoing survival of the company. All of this means that the founder’s assumptions make an enduring mark on the company’s organizational culture; however, growth, change and the passage of time inevitably lead to challenges to those assumptions from other family members and non-family managers. In addition, the original assumptions may be called into question as new threats and opportunities arise in the company’s “environment” that require new responses from the company in order for it to survive and prosper.

While it is certainly possible for the founder to remain in control of the management of the company for an extended period of time, and perhaps fill key management positions with other members of his or her family, more often than not the time comes when professional managers begin to fill key positions at various levels of the organizational structure. Schein observed that these professional managers are generally identified as non-family and non-owners and it is assumed that they are less “invested” in the company than the founder and his or her family members. Professional managers bring

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62 Id. at 781 (citing Ardichvili et al, 2000).
education and training that is specifically focused on management practices and techniques and this leads to skepticism regarding their level of commitment to retaining the original values and assumptions instilled by the founder during the early stages of the venture. While there is no doubt that professional managers can, and do, bring important organizational and functional skills to the business long-time employees often fear that these managers are only concerned about short-term financial performance and not the founding assumptions.

Schein commented that while there are “strong stereotypic components” in the above-described differences between founder/owners and professional managers, there do appear to be clearly discernable differences between the two groups based on personality characteristics and the position that founders/owners occupy in the governance structure of their businesses. Schein went on to illustrate these differences by suggesting “stereotypes” for founders/owners and professional managers based on four dimensions: motivational/emotional, analytical, interpersonal and structural/positional.

First of all, Schein suggested that founders/owners are oriented toward creating and building; achievement-oriented; self-oriented and worried about their own image; have a high need for “glory”; jealous of their own prerogatives with a high need for autonomy; loyal to their own company; and willing and able to take moderate risks on their own authority. On the other hand, professional managers are oriented toward consolidating, surviving and growing; power- and influence-oriented; organization-oriented and worried about the image of the company; interested in developing the organization and subordinates; loyal to the management profession and able to take risks albeit with more caution and need for support. Schein also suggested that founders/owners could be described as “local” while professional managers tended to be “cosmopolitan”.

Second, Schein believed that founders/owners are primarily intuitive, trusting of their own intuitions; tend to have a long-range time horizon and are more holistic, meaning that they were better able to see the total picture and patterns. In contrast, professional managers are seen as primarily analytical and more cautious about relying on intuition; tend to have a short-range time horizon, and are more specific in their world view with greater focus on details and their consequences. Schein noted that the founders/owners are more likely than professional managers to be willing to try new, and risky, innovations based on little more than intuition while managers would rarely pursue such projects without first going through an extensive formal process of documentation, justification and planning.

Third, Schein described founders/owners as “particularistic,” in the sense of seeing individuals as individuals; personal, political and “involved”; centralist and autocratic; and emotional, impatient and easily bored. In contrast, professional managers were described as “universalistic”, meaning that they saw individuals as members of larger categories or groups such as employees, customers or suppliers; impersonal, rational and

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65 Id. at 361.
66 Id. at 362.
uninvolved”; participative and delegation-oriented; and unemotional, patient and persistent. Not surprisingly, Schein observed that while family ties were very important for founders/owners they were irrelevant for professional managers.

Finally, Schein suggested that there are a number of significant and interesting structural and positional differences between founders/owners and professional managers. With respect to founders/owners, he observed that they have the privileges and risks of “ownership” and have a secure managerial position because of their ownership stake; are generally highly visible and get close attention; have the support of family members involved in the business, an advantage that is tempered by the corresponding need to deal with family members and decide on the priorities between family and company issues; and have “weak bosses” since their ownership position allows them to install directors who are passive and subject to control by the founder/owner. On the other hand, professional managers generally have a minimal ownership stake in the business and thus have fewer ownership privileges and risks; have a less secure position because of their small ownership interest and thus must constantly prove themselves; are often invisible and do not get much attention; go about their business without the support of family members, which also means they do not have to worry about the distractions that might arise from potential conflicts between company and family issues; and have “strong bosses” on a board of directors that is independent and not controlled by the manager. It should be noted, however, that the lack of family support does not mean that professional managers cannot and do not have their own non-family support group within the organization. In addition, whether or not directors of large public corporations are truly independent of the chief executive officer has been a point of content since the CEO has often been given substantial latitude in selecting directors, thus resulting a board that may be reluctant to challenge the decisions of the CEO.

Schein also observed that founders fulfill several other unique functions during the early stages of development of the organizations that they create. For example, because of their ownership position and high level of personal confidence, founders are better situated than professional managers to contain and absorb the anxiety and risk that are often associated with new venture creation and are unique situation to assure others in the organization about the survival of the firm in what appear to be troubled times. In addition, because they are the primary stakeholders of the firm founders can pursue strategies that may not be optimal from a strictly financial perspective yet are seen as necessary to embed that values and biases of the founder and achieve the personal objectives of the founder for the business. Illustrations of this include insisting on broad participation in decision making even if this slows the process, avoiding layoffs during periods when operational performance is lagging or insisting that family members perform roles within the company for which they are only marginally qualified.

Schein concluded that as the company grows and matures and professional managers begin to play a more significant role in the way the firm is operated and decisions are made it is inevitable that changes in the organizational culture will occur. Specifically, what Schein characterized as the “community feeling” instilled by the founder/owner eventually is overtake by the features of a more rational and bureaucratic organization
imposed by the professional managers who are not invested in the original assumptions and values and who are not able to fulfill the unique functions of the founders/owners described above. How much of the original assumptions and values will survive the transition to professional management, and in what form, is generally somewhat of a mystery; however, to some extent the answer depends on the personal growth and evolution of the first- and second-generation employees and how they integrate the assumptions and values with the lessons they learn on their own as they become more experienced managers. Schein referred to this process as “hybridization” and suggested that an enlightened founder/owner would recognize and accept that there are new assumptions that lead to better solutions for the new external and internal problems confronting the company and will permit these assumption to become part of the organizational culture of the firm, a culture that would, in Schein’s words, “maintain key old assumptions yet add relevant new ones”. Schein suggested that the success and ease of the transition through the hybridization process depends on the ability and willingness of the founder/owner to facilitate the transition and accept succession to the next generation without perceiving it as a political or power struggle. Many students of new venture creation and growth have observed that succession planning is one of the most difficult and emotional challenges for such ventures.

**Founders or Professional Managers?: The Israeli Experience**

The influence of venture capitalists from the US and Europe on their Israeli portfolio companies is often seen when decisions are being made regarding the role of the Israeli founders and whether or not a professional manager should be brought in to take on CEO responsibilities. Many of the issues that must be considered are not that different than those that arise when the investors and founders are all from one country, such as the US; however, cultural differences must be taken into account when, for example, US venture capitalists are insisting on bringing in experienced professional managers to oversee all of the operations of an Israeli firm (i.e., a CEO) and/or an important function (e.g., a CFO to make sure that “costs are being controlled”). Tolkowsky, who has studied the experiences of a number of Israeli technology startups, reported that attempts by US venture capitalists to appoint a US CEO without placing one of the Israeli founders on a “shoulder-to-shoulder” basis with the US appointee (even if reporting to the CEO) had generally not been successful. Another attempt by US investors to impose on the management structure of an Israeli company was demanding that the company recruit a US-based CFO and this also was counterproductive since it deprived the CEO, who was Israeli, with close and easy access to a senior management team member with whom the CEO needed to have a trusting and intimate relationship.

**Sources:** G. Tolkowsky, Globalization of Technology Ventures: Lessons from Israel, Knowledge@Wharton (August 17, 2009).
About the Author

This chapter was written by Alan S. Gutterman, whose prolific output of practical guidance and tools for legal and financial professionals, managers, entrepreneurs and investors has made him one of the best-selling individual authors in the global legal publishing marketplace. His cornerstone work, Business Transactions Solution, is an online-only product available and featured on Thomson Reuters’ Westlaw, the world’s largest legal content platform, which includes almost 200 book-length modules covering the entire lifecycle of a business. Alan has also authored or edited over 90 books on sustainable entrepreneurship, leadership and management, business law and transactions, international law and business and technology management for a number of publishers including Thomson Reuters, Practical Law, Kluwer, Aspatore, Oxford, Quorum, ABA Press, Aspen, Sweet & Maxwell, Euromoney, Business Expert Press, Harvard Business Publishing, CCH and BNA. Alan is currently a partner of GCA Law Partners LLP in Mountain View CA (www.gcalaw.com) and has extensive experience as a partner and senior counsel with internationally recognized law firms counseling small and large business enterprises in the areas of general corporate and securities matters, venture capital, mergers and acquisitions, international law and transactions, strategic business alliances, technology transfers and intellectual property, and has also held senior management positions with several technology-based businesses including service as the chief legal officer of a leading international distributor of IT products headquartered in Silicon Valley and as the chief operating officer of an emerging broadband media company. He has been an adjunct faculty member at several colleges and universities, including Berkeley Law, Golden Gate University, Hastings College of Law, Santa Clara University and the University of San Francisco, teaching classes on corporate finance, venture capital, corporate governance, Japanese business law and law and economic development. He has also launched and oversees projects relating to sustainable entrepreneurship and ageism. He received his A.B., M.B.A., and J.D. from the University of California at Berkeley, a D.B.A. from Golden Gate University, and a Ph. D. from the University of Cambridge. For more information about Alan and his activities, and the services he provides through GCA Law Partners LLP, please contact him directly at alangutterman@gmail.com, follow him on LinkedIn (https://www.linkedin.com/in/alangutterman/) and visit his website at alangutterman.com.

About the Project

The Sustainable Entrepreneurship Project (www.seproject.org) was launched by Alan Gutterman to teach and support individuals and companies, both startups and mature firms, seeking to create and build sustainable businesses based on purpose, innovation, shared value and respect for people and planet. The Project is a California nonprofit public benefit corporation with tax exempt status under section 501(c)(3) of the Internal Revenue Code dedicated to furthering and promoting sustainable entrepreneurship through education and awareness and supporting entrepreneurs in their efforts to launch and scale innovative sustainable enterprises that will have a material positive environmental or social impact on society as a whole.

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