articles

The 10 Stupidest Things an Entrepreneur Could Do

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Entrepreneurs are forced to go up a steep learning curve, innovate, and sometimes learn by trial and error in order to survive the treacherous tightrope of startup life. Wouldn't it be nice to avoid some of the costly mistakes of trial and error? LawPivot co-founders Jay Mandal and Nitin Gupta plus Yusuf Safdari, an attorney providing advice to companies on LawPivot, collaborated to generate this list of the 10 stupidest things that an entrepreneur could do.

1. **License away the crown jewels.** Entrepreneurs sometime bow to pressures from early customers and partners and do not properly protect the crown jewels of their company: their intellectual property and/or product. Early stage companies, which often lack bargaining power in negotiations, are sometimes tempted to enter into agreements with partners or customers that give away too many rights to their products or intellectual property. For example, software companies have provided a license to customers that included rights ranging from outright ownership to certain parts of the code; an exclusivity arrangement for a geography or industry; or escrow rights to the source code that would be released to the customer upon certain events. This can cause consternation to future investors because these arrangements may hinder the growth of the company, inhibit downstream investment, or the value of the company in a future acquisition since its main intellectual property or product is effectively "handcuffed."

2. **Fail to protect intellectual property.** Even worse than licensing away the crown jewels is letting a competitor steal them. A company's intellectual property can turn out to be one of the company's most valuable assets—it can increase the valuation of your company, allow you to enter into strategic partnerships, and provide a barrier to entry to competitors. Entrepreneurs should take legal steps to protect their intellectual property as soon as they can to enjoy these benefits. Entrepreneurs usually hesitate to take steps to protect their intellectual property because of the cost and time involved. However, there are many cost-effective ways to minimally protect a company's intellectual property, and the little time spent upfront could be key to the success of a company. It is an imperative that you protect and secure your intellectual property through invention assignment agreements with each of your employees and others touching your intellectual property. On IP matters, don't be the entrepreneur that is penny-wise and pound-foolish.

3. **Lose key employees.** The most important asset that an early stage company possesses besides its intellectual property is its employees. Technology acquisitions are primarily based on talent and technology (and more so talent in the case of smaller companies). Companies should compensate employees based on assumptions that they can share with employees and incentivize them with promotions and bonuses for great work. This will help ensure that employee morale is high and that your employees will go to battle with you without reservation -- and without one eye on the job board for a better opportunity!

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- Entrepreneur Boot Camp: Volunteering
- How to Raise Capital for Your Business
- Entrepreneurs and Defining Points: Have You Had Your Popeye Moment?

4. **Sell too much equity to investors.** Entrepreneurs who have worked so hard to build value in their company also give away control of the company, and other rights, in the course of a seed or venture investment. Major rights that are conceded by an entrepreneur include setting a low valuation of the company, allowing investors to reset the vesting schedule of their stock options, and providing strong preferential rights to investors (such as multiples of liquidation preferences that greatly reduce what entrepreneurs would receive upon an exit). See the prior article The 10 Biggest Booby Traps of Term Sheets for more details.

5. **Create inequities among founders.** Entrepreneurs need to think through the division of equity ownership among co-founders. Otherwise, they will waste a lot of time and ownership issues will create hostility. Entrepreneurs are often so focused on starting up a venture that this issue slips their collective minds. It makes sense for the co-founders to spend some time in the early stages to agree on what the ownership structure of the venture should look like in order to align incentives and fairly compensate for past and future contributions to the company. The co-founders can then

assess each other's expectations and come to agreement, and even in the worst case, walk away if the expectations of any co-founder is unreasonable. As a starting point, it is easiest to split equity ownership equally among co-founders so that each of them is equally incentivized to grow the company. However, different people bring different skills, capital, connections, or other items of value to the table, which would justify why there should be different equity percentages owned by each co-founder.

6. **Over-optimize deal terms.** In order to be successful, an entrepreneur is forced to develop an impeccable sense of timing and know when to jump on an opportunity that is presented. Many entrepreneurs have passed up on an investment because they thought that they could get a better deal or a better valuation. Then, all of a sudden, there is no better deal and they are on the verge of going belly up because of a burn rate that they cannot sustain. The first rule of raising money is to take a reasonable deal immediately if it is offered to you. This quickly separates the smart entrepreneurs from the pack.

7. **Let advisers freeload.** In the early stages of a company, entrepreneurs may make the mistake of giving sizable stock grants to "advisers" to the company that end up providing minimal, or no, value. We see this in early stage companies where an entrepreneur is overly impressed by the credentials of a potential adviser. The entrepreneur fails to conduct any further diligence on the adviser that would have helped him determine that the adviser is too busy, not engaged, or not the right type of adviser. Admittedly, this will not lead to the undoing of the company, but unnecessary dilution of the company may occur. Make sure that your advisers are on vesting schedules and don't hesitate to terminate them if they do not perform.

8. **Lack preparation for negotiation.** This is the classic problem where an entrepreneur goes into a meeting or negotiation with a partner or investor and decides to "wing it." Keep in mind that if you are an early stage entrepreneur, you often only have one opportunity to present your company. If you come ill-equipped for such a meeting, it would be better to reschedule or not waste your or the other person's time. In the worst case scenario, this could lead to negative news spreading about your company—for example, investors are famous for sharing knowledge about potential investments. It is best to take time to prepare for a meeting with knowledge on the positioning of your company, background on the partner or investor, questions that you anticipate would be posed to you, and the proposed terms of a business deal or investment deal.

9. **Hide weak points.** Entrepreneurs sometimes wait until the last minute to reveal the major weak points of their company in a deal such as a strategic partnership, financing, or sale of a company. In such a negotiation, it is best to be upfront about the strengths along with the weaknesses of the company so that it sets the proper expectations in the negotiations. This establishes that an entrepreneur is negotiating in good faith and builds credibility. Providing both "the good and the bad" also tempers the weak points and tends to focus everyone on the material terms of the deal. Despite our warnings, entrepreneurs have chose to hide the warts of a company, but this is playing with fire. At worst, the deal could blow up at the last minute and, at the very least, this could lead to a disgruntled partner or investor and a strained long-term relationship between the parties involved.

10. **Lose focus on what's important.** We leave this for last, because this may be the most obvious but, if ignored, is definitely the most fatal to a company. The company's products, services and customers are, and should always be, the primary focus of an entrepreneur. Lawyers, investment bankers, and management consultants-turned-entrepreneurs are the ones most likely to forget this. They may revert back to tackling other issues in their comfort zone, instead of focusing on the products, services, and customers. This also leads to the corollary issue of not getting busy in the day-to-day tasks—always see the forest for the trees.

To avoid these types of blunders, take a look at LawPivot. There you can submit questions to the right lawyers who will confidentially provide answers.

Tags: *lawpivot, jay mandal, startup, guy kawasaki, entrepreneur, nitin gupta, best practices, yusuf safdari*

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