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Cash Is Not Always King in Founder/Investor Relationships

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> Knowledge, reputation, and personal ties can also be leveraged and weaponized, setting the stage for clashes and disruption.

Power, the capacity to influence outcomes positively or negatively, is rooted in capital. Researchers and business leaders often believe that financial capital, such as equity, provides an indisputable source of power in organizations. Perhaps nowhere is this belief more taken for granted than in new ventures, where founders often give up majority ownership stakes and thus influence over venture affairs to investors brought on to fuel growth.

However, our recent research tells a different story. In an article recently published in *Academy of Management Perspectives,* we discovered that power dynamics at startups are more complex, and that non-financial capital, such as knowledge and reputation, also underpin influence. Our work involved an extensive review of research on the linkages between power and capital. And it also explored how different capital forms led to an unexpected power struggle between the founder and investors of Balcones Distilling, a Texas-based startup.

Our work yields some practical insights for both entrepreneurs and investors, as well as other stakeholders and interested parties, on how different types of capital can be wielded and shared, regardless of the size of the parties' investments.

Power Goes Beyond Money

Power refers to the capacity to influence outcomes positively or negatively (Lukes, 2018). While individuals and collectives accumulate and exercise power from many forms of capital (Bourdieu, 1977), one form—financial capital—receives the lion's share of attention (Clough et al., 2019) because people with financial capital can leverage others' dependence on them for resources (Ocasio et al., 2020: 308).

However, people with less than a controlling financial interest in the company can also hold much influence. For example, research on more than 16,000 founders revealed that about half remained the organization's chief executive—an indicator of power—by the third round of outside funding (Wasserman, 2014). Another study found that 40% of founders remained CEO by the time of initial public offering (IPO), which is a late-stage milestone in venture development (Fried & Broughman, 2018). Many of these founders continued to enjoy meaningful, post-investment power, which must stem from non-financial capital. And they can enjoy this position of power as minority owners who give up little of their remaining equity to investors.

We've also seen the disruptive results when these different types of power and influence collide with each other within an organization and imperil its well-being. For example, Elizabeth Holmes of Theranos was an expert storyteller who leveraged that skill to exercise influence from various forms of non-financial capital, leading investors to pour more than $700 million into her company. Specifically, she convinced investors that Theranos' technologies revolutionized blood testing by simplifying it. After reporters investigated and debunked these promises, it spelled the downfall for the entrepreneur and venture alike, not to mention the destruction of value for a diverse set of stakeholders (Carreyrou, 2020). Theranos shut down and Holmes

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remains in prison.

Open AI serves as another example. In November of 2023, when it was arguably the hottest company in tech at the time, Open AI faced the possibility of collapse as its board fired, replaced and then ultimately rehired CEO Sam Altman. Although unclear, the initial firing of Altman presumably was based on disagreements about the company mission; the board of directors (at the time) was focused on safety and transparency, while Altman was more focused on technological progress and growth. Nearly 95% of open AI's employees threatened to quit after Altman was fired, suggesting that he had earned their devotion through attributes that went beyond his financial stake. Within a few days, OpenAI announced Sam Altman's return along with new board members.

Many Kinds of Capital

As these examples show, controlling the purse does not equate to controlling the organization. Researchers – most notably Ocasio et al, 2020 -- have identified many types of non-financial capital that influence organizations and their stakeholders. Their insights are summarized and simplified below.

Cultural Capital

People with cultural capital embody and deploy the "language, cognition, values, and indicators of the organization or social system." Their power comes from understanding the "rules of the game" and playing it skillfully.

Knowledge Capital

People with knowledge capital have "organizationally relevant individual abilities, talents, education, and experience, formal or informal, tacit or explicit, and independent of structural position." They know how to use this knowledge to access data and control access to information.

Social Capital

People with social capital know how to bond with others, and bring others together so that important information can be shared. They understand "the ties that exist in social systems, including affiliations, sources of information, referrals, and commitments available through social networks that might enhance [their] position."

Symbolic Capital

That co-worker who was recruited and deferred to because he or she went to Yale? That person has symbolic capital – defined as "category membership, whether acquired—job titles, credentials, formal educational degree, functional background—or ascribed—gender, race, ethnicity, and age." People who've founded other companies or who held high positions in them also fall into this category.

Reputational Capital

Consistently high performers fall into this category, which is defined as "derived from perceived reputation for successful performance within the organization or relevant external contexts, [which are] not necessarily connected to actual performance."

Organizational Capital

This type of influence comes from being in a critical position within the company, which empowers the person to make important decisions and set the agenda. It's defined as "derived from control over strategic resources, discretion and legal authority, reward, and coercive power afforded to certain organizational positions."

Institutional Capital

This type of power is "based on institutional capital requires being able to shape, not simply embody and leverage, organizational culture, rules, norms, etc., creating new classification systems that are assumed to be normal and natural aspects of organizational life (Lukes, 1974). People with institutional capital define the "rules of the game" and what is valued within the company.

Financial vs. Non-Financial Capital at Balcones

The story of Balcones Distilling, a Texas-based craft whiskey company, illustrates that power over new ventures can arise from financial *and* non-financial capital. Evidence of this premise takes the form of a power struggle between founder Chip Tate -- who had a reputation as a master distiller (reputational and knowledge capital), a strong bond with Balcones' stakeholders and customers (social capital), and final say over the board's decisions (organizational capital) -- and major investor Greg Allen of PE Investors, who controlled both the cash and the board of directors.

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Much more detail about how the company unraveled can be found in the EIX article here (https://eiexchange.com/content/How-a-distillery-founder-and-his-investor-went-off-the-rails?search=balcones) and in our full research paper (https://journals.aom.org/doi/abs/10.5465/amp.2023.0223?journalCode=amp) , but to summarize: About 18 months after the partnership with Allen, Tate left the business after a bitter rivalry with his investor and the board. The saga included a court case, reputational damage, and even alleged death threats.

The power struggle began with over a decision vital to opening a new plant that would expand production. Tate favored buying a less expensive facility that would not operate during the hot Texas summer months and Allen and his board favored a more expensive year-round facility.

That skirmish touched off a battle that increasingly involved both participants trying to influence the other using different types of capital. While Allen and his board controlled a majority equity stake, which legitimated their authority to make key decisions impacting the venture's future, Tate leveraged his non-financial capital – such as his own professional relationships and reputation, his contract terms with PE Investors, and his extraordinary knowledge of the craft whiskey business -- to get his way. Because he became the "founding manager" after PE Investing stepped in, Tate was able to exercise this organizational capital and block certain board actions—especially those that would diminish his involvement with Balcones.

When the investors proposed that Tate step down as CEO, Tate refused and began to skip board meetings to prevent a vote on the matter. When the battle spilled into the courts, Tate claimed that the board was overstepping its authority according to the terms of the operating agreement—a claim enacted through resistance.

While Tate won an early battle in court, the good will that inside stakeholders accorded him began to deteriorate. The board accused him of being hostile to employees and investors, and being abusive and prone to displays of rage, including making death threats. Tate's ability to broker crucial information flows at his own company was severely impaired after the board ostracized him, thus reducing his overall capital stock—particularly social capital—and limiting his ability to exercise any remaining organizational or symbolic power. Ultimately, Balcones employees began to see the investor-directors as a stabilizing influence during a tough time.

However, Tate continued to enjoy substantial social and reputational capital outside of the company. He had spent extensive time telling Balcones' story and romanticizing its wares to industry bloggers, reporters, consumers, peers, and others. Tate mobilized his long-established reputation with influential people in the external social network to support his cause. Bloggers and reporters sought, obtained, and disseminated Tate's side of the story, to the point where investors sought a gag order. A "No Chip No Balcones" movement launched on social media.

Ultimately, Tate and his investors leveraged non-financial and financial capital, respectively, to exercise equivalent influence over Balcones, resulting in a stalemate that neither side could break and that became too much for the relationship to endure. By mutual agreement, Tate left Balcones and started another company. Eventually, PE Investors and other stockholders sold Balcones to Diageo in November 2022.

Takeaways

The events at Balcones, and other companies like it, offer some takeaways of potential use to entrepreneurs and investors as they plan their relationships and work together:

Becoming powerful results from accumulating financial, non-financial capital, or both. Understanding this point can foster relationships that unfold harmoniously rather than contentiously, improve relationship quality and stakeholder support, and help the company minimize the roadblocks to achieving its goals. It's a mistake to assume that equity in an organization always equates to influence, even when (majority) owners run the business.

Exercising power means using capital. By implication, capital unused means power lost. Research (Ocasio et al, 2020) has found that capital accumulated by entrepreneurs and investors remains little more than potential power sources unless used in pursuit of desired outcomes. Unless it's activated and mobilized, it has no actual value and may be diminished or lost over time. For example, Tate won his first court case

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because of his organizational capital: the agreement that codified his rights as "founding manager" and the board's voting protocols. He would not have won if he had assumed that Allen's financial stake would trump everything and didn't choose to leverage his organizational capital.

Exercising power means winning in some arenas and losing in others. For example, when Tate exercised power from his organizational capital to resist the investors' initiatives, he weakened his social capital with the investors and Balcones' employees. These dynamics saw the investors strengthen, and the entrepreneur weaken, their cultural capital within the venture. As Tate eventually left Balcones, winning in court turned out to be a pyrrhic victory of his own making. The lesson here is that entrepreneurs and investors should recognize that successfully wielding influence depends not only on leveraging more or better capital but also on maintaining or securing support from venture insiders.

Being powerful might (not) matter. Power matters for achieving some goals, but not others. For example, entrepreneurs often choose between getting rich and being king**.** Getting rich involves taking on investors to help scale up ventures, whereas being king entails locking out investors to control the venture (Wasserman, 2008). When scaling is the goal, entrepreneurs might forego personal safety nets and cede decision-making authority to investors—with caveats, of course.

When staying in control is the goal, entrepreneurs can negotiate operating agreements that preserve at least some of their post-investment influence (cf., Sarason & Dean, 2019). Balcones' founder initially accomplished this with his earlier-stage investors. When PE took over, Tate persuaded his new investors' attorneys to revise the operating agreement in ways that codified his desired roles, board voting protocols, etc.

Alternatives for staying in control can involve foregoing investors altogether or find those not primarily motivated by financial returns, such as friends and family. Balcones' founder might have been better off following the latter path, which he appears to have done at his new venture. As the founder discovered, even the most careful vetting and planning processes cannot overcome the motivational divide between entrepreneurs who want to run their businesses and investors who want to optimize financial returns.

Learn More

Ourarticle(https://eiexchange.com/content/How-a-distillery-founder-and-his-investor-went-off-the-rails?search=balcones) has much more information about how entrepreneurs can craft the right agreements with investors and deploy and preserve their full suite of non-financial capital.

Explore the Research

More Than Money: The Complex Dynamics of Capital and Power in Entrepreneur–Investor Relationships (https://journals.aom.org/doi/full/10.5465/amp.2023.0223) , *Academy of Management Perspectives*, October 2024.

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