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In the final episode of our “Entrepreneurship and Ethics” miniseries, Stanford professor Tom Byers asks two leading venture capitalists — Floodgate co-founding partner Anne Miura-Ko and NEA managing general partner Scott Sandell — how the VC community can incentivize ethical leadership in the companies they fund and manage.



Transcript

- It was one of these offhand comments that I would have not necessarily thought to really check on, but when we did, we couldn't find a single piece of evidence that this was true.. - We don't accuse people of being an (indistinct) we just don't fund them.. - It's not like someone is born just a bad equal human being that they're gonna start a company to do bad evil things, and so the question of like, where does this start? How does it happen? - Welcome to entrepreneurship and ethics, a special mini-series, we're presenting on the Stanford Innovation Lab podcast.. I'm professor Tom Byers and I teach entrepreneurship in Stanford School of Engineering.. Today on the final episode of this mini series, we're looking at how venture capitalists can help founders and companies follow the principled path.. I've invited two truly impressive venture capitalists to join me today.. And Miura-Ko is the co-founding partner at Floodgate and influential seed stage venture capital firm.. Scott Sandell is the managing general partner at New Enterprise Associates.. One of the largest and most respected venture capital firms in Silicon Valley.. I hope you enjoy our conversation..

To kick things off, I first asked them why and their experience startup founders sometimes go off the ethical ramps.. - Silicon Valley has changed quite a bit in the last 10 years.. When I first got started with Floodgate, it was one of these things where most people didn't do a startup, it wasn't a career path.. And today, you know, there's a career path in being a founder.. And so as a result, whether it's the Shark Tank TV show, Silicon Valley, the TV show, social network, the movie, there's a certain Hollywood implication of being a founder that lends it a superstar status.. It also used to be that you would never talk about your valuation or how much you've raised and suddenly that's the thing that people want to talk to journalists about.. And so I think that there's a certain element of why our founders hear that isn't as clear as it was maybe back in the day, there are reasons why founders might sort of fall off the rails in ways that we haven't necessarily always seen.. - What I remember coming to Silicon Valley in the 80s is that people by and large came to Silicon Valley to change the world.. They were most often engineers and technologists.. They were hugely motivated by what their technologies and products could do..

And they tended to be a lot less focused on money.. You know, certainly some of them thought about what might happen, but it wasn't their principle driver.. And that changed sometime, I think in the nineties, maybe the late nineties, but as Anna alluded to, you know, now there's this, this even additional motivation, which is to be famous.. - We think a lot about actually the founders and their value system.. And part of the way we try to get to this, is through back channel referencing.. And I'll give you one story, in particular, there was a founder that we met with and another angel was sitting in the room with us meeting with this company.. And the founder had in his profile, he had offhandedly mentioned that he was a Tetris World Champion and the angel said, well, that's really easy to back channel.. You should just try to figure out if that's true.. And it was really interesting cause it was one of these offhand comments that I would have not necessarily thought to really check on, but when we did, we couldn't find a single piece of evidence that this was true.. Everything was an article where the founder had said it himself..

And so I went back to that founder and I said, you know, I know this might seem really strange, it has nothing to do with your business, but because it was in your pitch, I just need to get some evidence that this was true anywhere else.. And the next thing I know, even though we're in pretty deep conversations to fund the business, the guy literally disappeared.. And my partner to this day points to that and says, you know, "how much did we save ourselves from something?" - I think what

people really don't appreciate is that some ethical lapse, somewhere along the way can have very long-term consequences that are generally speaking, not known to the person, because nobody wants to say to a founder, you know, "Hey, that's a great pitch, but we've heard that you're a liar." And therefore the conversation just stops.. We don't accuse people of being unethical.. We just don't fund them.. And you know, I've seen countless examples of this going all the way back to somebody that I went to business school with, who, you know, was known to have lied, you know, by a number of classmates and, you know, we didn't fund him later, but I think most people just don't have any appreciation for how unethical behavior can close doors that you never even see.. You know, we've talked before Tom, about this idea of ethical risk.. You know, we fund lots of kinds of risks and one of them is how much we trust the founder.. And if we can trust the founder completely, and maybe we give them complete control of their company as a result of that happens somewhat commonly in the modern world didn't used to happen.. But we also recognize that in cases where we don't feel that we can trust somebody that much we'll set things up in a way where, you know, we are not as exposed, if there's some kind of ethical risk or fraud..

- One of my favorite models and it's been around for a long time, is this risk reduction wheel, as some people call it where people assign a metric to the greatest risk at this moment, is it market as a technology? Is it tenure and so on, but, and do you have a view on this concept of an ethical risk being an additional part of that wheel? - I think all things considered equal.. You wouldn't want to have that risk, but at the same time, you're funding entrepreneurs that they usually have this rule breaking mechanism inside of them.. That's, partially what fuels an entrepreneur, is that they don't live by today's rules.. And then the additional question is, are the rules themselves, are there moral character to them or are they procedural rules? Are the rules just wrong to begin with? And I think really having founders who can discern those differences is really important.. In funding a founder, we're actually funding someone who is designing a completely new future and inherent in that is some element of breaking what happens today.. And, I think that's where things become tricky.. And for us making sure that our founders are not just taking on massive ethical risks, it's a big issue.. And it's something that as a partnership we would really think through because that's a huge burden, you know, it's already a big burden to take on financial risk and technical risk, and market risk.. And then on top of that, like how much of that extra burden do you wanna take on the real question is how much are you looking over your shoulder and how much do you feel like you have to look over their shoulder? You don't wanna be micro-managing founders.. - Scott, what's your view at NDA? - Well, I mean, I think like and we generally don't like to take ethical risk at all, but it's not that there are cases and there aren't cases where we have, because we certainly have..

And one of the most interesting things I find in our partners meetings is that oftentimes somebody who's less familiar with the domain and doesn't quite get into all the product stuff and excited about the market opportunity might be say, a med team partner sitting in on a tech team presentation is more likely to just focus on the person and be able to notice their behavior and the things they say and come away with an impression of whether this is an honest person or not.. And that's usually what comes up in the discussion to follow.. But if there are any serious doubts, you know, we just don't fund people who we can't trust because we're essentially committing a pool of capital without the ability to take it back for very long period of time.. And that pool of capital, is entirely in the hands of the entrepreneur most of the time, unless they get fired.. But that's obviously not something you ever wanna do.. (upbeat music) - After deciding to backup, given startup venture capitalists continue to influence the companies, they found as board directors.. I was curious to learn more about the ethical implications of those board roles.. I asked Anne and Scott about their experiences on their governance boards.. What levers do they have in those roles to encourage ethical decision-making? - I Spend, I would say 90% of my time on seed stage boards.. And they're the major questions that we think a lot about are the ethical frameworks of where is this product ultimately gonna go where could it go wrong? And founders are actually talking about this a lot earlier than even five years ago, especially as they think about data..

But I think, you know, as it gets to a team of 10, even 25 people that then you're thinking about, team, hiring, diversity.. Those are things that also come into the mix.. Pre-IPO, fairly scaled businesses.. I think then it becomes much more complex in terms of you're basically governing mini society in some sense.. And, there are a lot of additional questions to look at.. - Scott - Well, I think the thing, that we focus the most on is that the founder themselves, if they are the CEO of the company, is in a very unique place, which makes ethical behavior more important than for anyone else in the picture, because they represent all constituents in negotiations on behalf of the company.. And so if they insert themselves and their own interests into those negotiations, you know, they can get into very dangerous water very quickly.. An example could be they're selling the company and the buyer says, you know, geez, what if we give you guys an extra incentive on the back end of this deal, we're gonna give you another 5% of the company, but your shareholders can't participate in that.. You know, I'm not saying that that's, that there aren't conditions under which that's a reasonable thing to think about.. If that founders, in fact, committing themselves to another term of service in the acquired company, they should be compensated for it..

But if they don't recognize that they are in pretty dangerous water in that negotiation and a minimum share, exactly what's going on and what the trade-offs are with the board, you know, they can very easily be conflicted and make, you know, ethical lapses.. What we try to emphasize with founders is how important it is that they think about the role that they have and how the standards for them have to be even higher.. - So what is the role of board in this balance between the natural optimism of a CEO or the founders with making sure they don't get too far ahead of themselves and start misrepresenting what is going on not only to the board, but you know, to other audiences in general.. - You have to listen carefully for the boundaries between what's possible and what's being represented to be true today.. And, that's where people get in trouble, because of course it is the founder's ability to paint a picture if you will, of what's possible.. That gets people excited about the company, including venture capitalists and other board members, employees that they're recruiting, you know, all the constituents of

the company need someone to be able to paint that picture of what the world could look like.. You know, that, you know, this market, which doesn't exist today could be very large because of what we can offer to these customers, that sort of thing.. But I do, I think where people get in trouble, is when they suggest things that are not yet true to be true.. And so as a director of the company, you know, what we try to do is when we see those lapses, you know, we try to call them out, maybe not in a public setting.. It would say somebody presenting to my partnership for an update..

And I see two or three things that I know are not true, but they could have just said to my partners are true.. I wouldn't call them out in front of my partners, but I'd take them aside afterwards and say, "Hey, look, that's really not cool.. You can't do that.. Let's just stick to what you know, what's true.. You got plenty of good stuff here.. And my partners are gonna get really turned off, if you don't stick to what's true.. - Yeah, we always joke at Floodgate.. There's like a fine line between the visionary founder and the founder having visions.. And it's tough to really tell the difference sometimes, you know, we rely a lot on initially on a diligence.. So just understanding how close to reality, is what this person says that they can build..

And then, I think it is just sort of holding people to high standards and calling people out, if it isn't, if something isn't true and I love the way Scott talks about it, of like not doing it in public, it's not about shaming the person, but really teaching them that it's not okay, and actually the progress that they're making is the right kind of progress.. - Oftentimes the progress of the company is super impressive.. They don't need to over-represent what's true today.. You know, the real progress combined with the excitement of what's possible is plenty enough to get venture capitalists excited enough to write the next check, conversely, one or two little slip of things that are not really true, call everything into question.. (upbeat music) - While boards directly hire and fire the CEO they can also influence how a company thinks about its hiring strategy more broadly.. For many of us are teaching practice entrepreneurship, the need to build more diverse networks and companies has been front and center this year.. I was curious to learn how Ann has got think about their roles when it comes to advocating for diversity in the companies they fund.. - Some level, it's an ethical issue, and some level it's just an operational issue.. It's an issue of performance and access to incredible networks.. And so if we want the very best network effects in our hiring practices, and if we're looking at building a great company for the longterm, then having a great diverse team, whether it's, you know, the management team, the individual contributors at the board, the investor set, it's really important to have..

And so, and I don't think about it, just in terms of gender balance, but I think about it just in terms of perspective.. And making sure that we have a wide variety of perspectives at the table when we're making, any kind of important decision.. People routinely come from other parts of the world, wondering why Silicon Valley has produced so many amazing things.. And it seems pretty clear to me that it's the diversity of people in thought that come from all over the world and by and large are treated equally, which doesn't happen everywhere.. So we're huge proponents of trying to encourage diversity in our partnership, in our companies, in all aspects of what we do, as Ann said, it's been an issue for a really long time.. And I think we have a long way to go, obviously, but more recently, it's taken on a renewed focus.. I would say in the last five years, it has become one of the four or five most important objectives for a company as it develops over the course of a year or two, you know, and it's absolutely a subject of board-level conversation on a regular basis.. And by the way, I think that's making a big difference if I just look at gender diversity, which seemed to have a little bit more energy around it a couple of years earlier than some of them were recent diversity questions.. There is a lot of progress being made on gender diversity, and it's also not surprisingly, we're making a wonderful difference.. - A lot of it has to do with just the desire of people to report and, you know, a while ago, it was really hard to get people, to even talk about it and provide the data..

And today I'm even seeing limited partners who are invested in these venture capital firms asking for that data with respect to the investors in general partners within these firms.. And so, and the same thing for us, as you know, we're asking the question of, we want the data in terms of how are we performing with our investments? What kind of diversity do we have? And, then even within our investments, they are collecting the data and how diverse their employee bases.. And so the fact that people are gathering the data, the fact that people are asking these questions of themselves and of each other, I think it's a huge step forward.. (upbeat music) - This is exciting to hear and mentioned that limited partners are becoming more interested in things like diversity data limited partners or LPs for short, are the people and entities that invest money with venture capital firms, maximizing the returns on their investments is always important, but as Anne points out, they have other values as well.. I was curious to know whether Ann Scott has observed a trend of limited partners becoming more concerned with the ethical implications of their investments.. - Indisputably, I mean, I think a lot of limited partners are sources of capital that have their own set of constituents, whether it's a state pension fund or a sovereign wealth fund, or an endowment for a university, all of these pools of capital are accountable to somebody.. And so all the issues that we've been discussing come to light in terms of the focus they place when they make investments another simple way of saying it is, they do just as much due diligence on us as we do on our founders.. And they're just as sensitive to all the same issues.. - And I see this with many of our limited partners.. I feel fortunate that we have very close relationships with them and so they will ask us tough questions and they will also do diligence on other firms and try and understand if there's an ethical concern, they will reach out and ask the tough questions..

And I think that that makes for a better environment because it causes us to always stay on our toes.. And so I know that our limited partners have high standards because they've asked me questions about other firms.. And, so as a result of that, I maintain this high standards.. I love the fact that they are asking these questions and that we can have an open dialogue with them.. And so I think the more these limited partners push, the better it is for the entire industry.. - No doubt about that.. Everyone, all humans do better when they're accountable to something or someone.. And we are just as accountable to our

limited partners as our founders are to us.. And our behavior is being watched every bit, as much as their behavior and the consequences of unethical behavior are just as dramatic or more so in some cases, because our limited partners are absolutely doing background checks.. As Anne said, she gets calls about other people..

I get lots of calls about other people.. And so if, you know, if somebody is really acting in an unethical way, eventually it's gonna have an impact, as I said before, they may never know what that impact is.. It's sort of a silent consequence, but I have no doubt that, you know, especially a consistent pattern of unethical behavior will absolutely have an impact if somebody is in the venture business, and they're trying to raise money.. - I'm honored to say, than, in addition to their day jobs as venture capitalists Ann and Scott also have a hand in helping train our future leaders at Stanford University.. Anna his teaching leadership of technology ventures in the Mayfield Fellows Program.. And Scott is a collaborator with Jack Fuchs and his principled entrepreneurial decisions course.. So to wrap things up, I've invited him to weigh in on what they think is most important when it comes to teaching aspiring entrepreneurs and innovators about it.. - Many of our students come to it with a very clear sense of right or wrong.. And it's almost like my kids are this way too, there's good people and then there's bad people.. And when you peel the onion in many of these situations, you come to realize that that's just not the way the world works..

It's not like someone is born just a bad, evil human being that they're gonna start a company to do bad evil things.. And the investors are there to support them in their bad evil things.. And so the question of like, where does this start? How does it happen? Is such an interesting one.. And I think probably teaching students, the nuance of that is really valuable to me, even in my everyday work, cause it's a constant reminder that the ethical dilemmas that really show up in your world are not these obvious situations where you say, if I go right, I am heading down the wrong path.. And if I go left, it is totally the right path.. And so that nuance to me is probably one of the more important lessons.. And I relearn it every day.. - Well, you know, I think Anne put her finger on something really important, which is that ethical decisions are seldom all good or all bad.. If you start with the premise that ethics have consequences, which is a lot of what we've been talking about today.. And one of the things that we try to get across to the students in our class, then you realize that making these kinds of decisions is something you need to be prepared for..

And the best preparation is to have worked through a bunch of cases and to start to develop your own framework, your own set of principles, to think about or to help you think through these ethical dilemmas when they come along, and it's not that practice makes perfect, but having that practice of thinking through a bunch of these examples before you're faced with them, you know, often under a lot of time pressure and a lot of scrutiny can be really useful.. - I think one other thing, Tom, that's also come up for me is oftentimes these founders also have really good intent, you know, that whoever's making whoever has the ethical dilemma.. They may not realize even it is an ethical dilemma.. They have really good intent.. And sometimes it's just the wrong decision.. There's these unintended consequences and understanding what that might actually look like, playing it out and making sure that I dunno this movement, this revolution that you're creating, isn't going sideways for some reason.. - I mean, for me, I think the other thing that you see very clearly when you go through these cases, is that there's often a real cost to doing the right thing.. And so if you don't have a way to think about what the consequences are, it's very hard to take the expensive road, which might be the right road.. And I'm thinking of one in particular, which I think is a subject of one of the other podcasts, that's Jazz Pharmaceuticals, Bruce Cozadd, when you hear the whole arc of what happened to him in that company.. The thing that comes to mind for me is that if he wasn't guided by a set of ethical principles and values, he would have just gotten so lost along the way, which actually reminds me of something, which I wrote down and pinned up on my little wall in my office, which I hadn't been to in a while now, but it comes from Anne's partner, Mike Maples, and who once said to me, "integrity is the path where you never get lost." (upbeat music) - Well, that's it folks, the final episode of our entrepreneurship and ethics mini-series, if you missed the Bruce Cozadd conversation that Scott mentioned towards the end, it's easy to find, just rewind to the first episode of this miniseries..

The episode is titled facing the crisis with principals.. It's been a true delight to put together this entrepreneurship and ethics podcast.. And I hope it inspires students, teachers and practicing entrepreneurs to make ethics more central to their visions of what entrepreneurship and innovation is all about.. While this miniseries itself is coming end, Stanford eCorner's efforts to put ethics at the heart of entrepreneurship are only just beginning.. I would especially encourage you to also follow our entrepreneurial thought leaders or ETL podcast.. I'll include that link in the show notes.. This episode was produced by Luke Sykora and Rachel Julkowski for Stanford eCorner and edited by Katie Daniel Steussy is our designer and digital products manager.. Our growth marketing specialist is Nora Cata and I'm Tom Byers as always thank you for listening...