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From Founder Control to Fiduciary Duty: Rethinking Corporate Governance in Entrepreneurial Firms

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Abstract

The theory of corporate governance was developed to address a problem that entrepreneurial firms don't encounter. It is this separation of ownership from control that founder-controlled firms do not have; it is the tradition of agency costs that Berle and Means introduced back in the 1930s. But these companies have governance faults that are unique and acute, targeted at the late-private phase when resources mobilized are substantial, investors are diverse, and governance is more akin to a small private company. This paper shows that the governance problem in entrepreneurial firms is not due to an excess or deficiency of founder control per se, but to the mistiming of the shift between (two) governance regimes. We theorize on the concept of fiduciary gap, which is the gap between monitoring needs driven by the size and external value of a firm and the enforceable accountability that is demanded against those controlling the firm, and place it in a Governance Regime Transition (GRT) framework that encompasses four regimes, from founder to public. Seven propositions are formed. We explain why fiduciary doctrine is a structurally weak remedy for filling the vacuum in private companies: the duty of care is negated by the business judgment rule, the duty of loyalty is a somewhat intangible obligation for which only litigation is a remedy (and which illiquid minority shareholders are not likely to be able to litigate), and preferred-common conflicts leave the directors with irreducibly conflicted duties. The corrective is then ex ante institutional design and not doctrinal reform, and we set out calibrated instruments organised by transition trigger. In this paper, no invented statistics are reported because they would need to be collected from the firm; therefore, a simulation harness and an estimation template with placeholder notation are provided.

Keywords: corporate governance; entrepreneurial firms; fiduciary duty; founder control; dual-class shares; venture capital; startup governance; sunset provisions

1. Introduction

The separation of ownership and control is the canonical corporate governance issue. If the firm is a privately run corporation whose stock is held by widely dispersed owners, managers can work for themselves, at the expense of the owners, and the system of corporate law, board monitoring, disclosure, and market discipline is designed to limit the agency costs that flow from this (Berle & Means, 1932; Jensen & Meckling, 1976). This is the basis of the majority of current scholarship in the field of governance. Inverted in entrepreneurial firms. In a founder-controlled startup, ownership and control are the same thing, and the founder is going to have a lot of money in the company that they wouldn't put in a diversified shareholder. Those types of firms, on the conventional theory, should have little agency costs. The most obvious governance failures over

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the last 10 years, in practice, have been in these same companies, and it's been pretty consistent, much like the Monsanto case. The theory foresees the lack of the recurrent problem.

The answer to this discrepancy is found in two ways that are both incomplete in our view in the literature. The first, which views founder control as the disease, is a demand for limiting the ability to establish founder control, either by restricting the dual-class structure or by imposing mandatory "sunset" or by further extending the public-company regulation to large private companies. This response is quite strong in the context of founder control being redundant, but doesn't account for its ready and willing acceptance amongst the sophisticated investors who are certainly able to demand otherwise. In the second, founder control is seen as efficient because it ensures the preservation of the pursuit of an idiosyncratic vision (Goshen & Hamdani, 2016), which lacks value in the capital market and would otherwise cause the founder to be forced to give up. The answer is that the bargain well in the early stages is explained well, while the answer to the late stage is a pathology. This is because the same explanation that works for year two does work for year fifteen, when the conditions of information were no longer met.

The position that emerges here is that there are two correct accounts regarding different phases and that the problem of governance is in the transition between these phases. As firms grow, they go through a series of governance regimes, and they have a logic within themselves. Failing is not necessarily a failure because a firm is not in the wrong regime; it is a failure because the firm was in the regime previously, but now it's in the next regime due to a change in scale, capital structure, and stakeholder breadth. This is the fiduciary gap, which is the difference between the monitoring need created by a firm and the accountability obligations that can be imposed against a firm's controllers. In the founder regime the difference is insignificant because it is a regime of low stakes and having information is shared. It is small again in the public regime, where disclosure, rules governing exchange, an independent board and an active securities bar are instruments of accountability that are commensurate with size. It occurs in the middle, during the late-private phase when a company has raised billions, has thousands of employees and has an obligation to offer them illiquid equity, but they do not have the information nor the practical means to enforce the obligations they are formally owed.

The framing has a certain ramification on the meaning of a fiduciary duty in this context. A common argument for the use of fiduciary law is that it provides a solution to founder overreach, because fiduciaries are meant to be subject to duties which abate self-dealing and impose a burden of care. We believe that the current structure of the fiduciary doctrine is not well suited to bridge this gap in the private entrepreneurial firm, not for any defect in the doctrine to be sure, but because of features of the doctrine itself. Exculpation provisions and the business judgment rule make the duty of care mostly ineffective. Loyalty is active but is applied by ex post litigation, which is less likely to be undertaken by minority shareholders in private companies who lack the information, resources and interest to do so. The venture-financed capital structure thus puts directors in an irreconcilable conflict between the preferred and common stockholders, which has been recognized by doctrine but not overcome (In re Trados Inc. Shareholder Litigation, 2013). When there is no fiduciary duty to fill the gap ex post, the governance question turns to designing the institutions ex ante to do so.

The paper has four contributions. It defines the fiduciary gap as a measurable gap of governance, not a metaphor. It proposes a four-regime transition framework that includes explicit transition

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regimes triggers, and seven propositions based on it. It provides an analysis of the doctrine of fidelity in this context and explains how the doctrine falls short in this context as distinct from failure of enforcement. It provides an analytical protocol, a simulation harness, and an estimation template that specifies the evidence that would contradict the argument and not just substitute illustrative figures for evidence not obtained.

2. Why Entrepreneurial Firms Pose a Distinct Governance Problem

2.1 Three agency relationships, not one

The agency model, as it is typically defined, deals with only one vertical relationship between a dispersed principal and a principal who assumes a managerial role. Entrepreneurial firms embody at least three relationships and between each of these relationships, there are interactions that the traditional framework doesn't consider. One is the founder-investor relation, where investors provide capital before an incomplete contract, and founder(s) have a lack of transparency on the efforts and judgement used (Aghion & Bolton, 1992; Gompers, 1995; Kaplan & Strömberg, 2003). The latter is the horizontal relationship between the controller and minority stakeholders (Type II agency problem), which is prevailing in all concentrated-ownership companies and which is not given enough weight in the Anglo-American literature compared to its global prevalence (Shleifer & Vishny, 1997). The third is between the firm's decision makers and the residual stakeholders who suffer from firm-specific risk but no related control, primarily employees with illiquid equity compensation whose value is effectively determined by decisions they have no control over, and information they cannot access.

Entrepreneurial firms are different because a governance arrangement of one relationship often exacerbates another. The first agency problem is mitigated by provisions for protection of venture investors and by providing agency seats for these investors, while the second agency problem is exacerbated by the latter. Super voting rights of the founders deters opportunistic investors and gives rise to more entrenchment. That's why, it seems, unidirectional prescriptions, for more or less founder control, are more often than not wrong: they shift the value among relationships, but they do not reduce agency cost.

2.2 The verifiability asymmetry

Another unique characteristic relates to information. A public company in a ripe stage has a continuously observable market price for its performance and disclosure requirements create a verified informational baseline. The crucial variable in an entrepreneurial firm is the expected value of an untested strategy, one that cannot be verified by construction. This asymmetry warrants the party to whom the private information belongs to have control (the analytical backbone of the idiosyncratic-vision defence of founder control (Goshen & Hamdani, 2016)), and is why control rights in venture contracts are not fixed (Hellmann, 1998; Kaplan & Strömberg, 2003).

The key to the argument lies in the fact that the verifiability of the argument is not fixed. The more a company operates, has customers, and has financial transactions, the less the founder will have an informational advantage. However, there is an intrinsic time limit in the logic of the efficiency case for founder control, one not honored by the arrangements for perpetual control. This is the theoretical underpinning of the transition argument advanced in Section 5, and is one of the reasons

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why it makes more sense to debate between the idiosyncratic-vision and entrenchment positions on a temporal rather than categorical basis (Bebchuk & Kastiel, 2017).

2.3 The lengthening of the private phase

Capital markets' structure changed and a latent design feature became an operative problem. The private/public distinction was established in the belief that if firms grew large they would be listed and that this process would introduce the accountability and disclosure systems. This is no longer the case. The rise of late-stage private capital has enabled companies to achieve valuations, employment, and social levels that used to be the exclusive domain of listed companies, and for a decade or more, not just for a few years. The VC market that made it possible is an institutional success based on contract design, reputation, and exit infrastructure—it did not come with an extension of accountability architecture (Gilson, 2003).

The result is that a governance system which was developed for firms with a small number of stakeholders and where stakeholders are able to monitor their own work now regulates firms with thousands of stakeholders, where each stakeholder cannot monitor the others directly. In the scholarship on large private companies, it has been becoming a central regulatory issue in the contemporary private market, and has been recognized for the informational void it leaves, as well as the challenges for corporate law to fill that void (Fan, 2016; Pollman, 2019). That observation has been formalized and extended below to identify a time when the fiduciary gap arises in a firm's evolution, to explain why the gap tends not to close automatically, and to identify the instruments that can close the gap.

3. The Architecture of Founder Control

3.1 Mechanisms

Founder control is not some single entity but a series of devices that can be found at various places in the corporate structure that have materially differing levels of reversibility. They are listed in table 1. The reason for the layering is that it results in a more resilient control—one layer that an investor eliminates may be offset by the other, and the combined impact of all the layers is often more than the sum of its parts. It is also important because the devices vary significantly in ease of unwinding and this is a key issue in the transition problem. The composition of the board may be renegotiated at every financing round and a dual-class charter, if adopted and implemented at an IPO, is virtually permanent if not for a sunset.

Table 1. Mechanisms of founder control

Mechanism	How control is exercised	Legal locus	Reversibility	Principal cost when retained too long
Dual-class or super-voting shares	Voting power decoupled from cash-flow rights	Certificate of incorporation	Very low absent a sunset provision	Entrenchment insulated from market discipline

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Mechanism	How control is exercised	Legal locus	Reversibility	Principal cost when retained too long
Board seat allocation	Founder-designated majority or deadlock-proof composition	Voting agreement; charter	Moderate; renegotiated at financings	Board ceases to perform a monitoring function
Founder-CEO combination with chair	Agenda control and information gatekeeping	Bylaws; board resolution	High in principle, low in practice	Information reaching the board is curated by its subject
Voting agreements and proxies	Aggregation of other holders' votes	Contract among shareholders	Moderate; terminates on defined events	Formal minority holders lack even nominal voice
Founder consent and veto rights	Blocking rights over defined corporate actions	Charter protective provisions	Low	Value-increasing transactions can be unilaterally blocked
Informational asymmetry	De facto control through what the board is told	No legal locus; practice	Depends entirely on board initiative	Oversight failures of the Caremark type

3.2 Competing normative accounts

There are four normative positions on the issue of whether such arrangements should be allowed and they do not disagree on the grounds that are merely empirical.There are four normative perspectives on whether these arrangements should be allowed or not, and they differ not only on the empirical grounds but also on the theoretical ones. They are on their way with their predictions in Table 2. The idiosyncratic-vision argument is that the value of strategies that the founder is not able to credibly communicate is protected by control and that its elimination harms value (Goshen & Hamdani, 2016). The entrenchment account states that any justification for the ongoing control of the initial control after the founder's cash-flow stake in the firm has been reduced serves to create a small-minority controller with incentives that significantly diverge from those of the residual claimants to the firm, and that the costs of this divergence increase over time (Bebchuk & Kastiel, 2017, 2019). In the incomplete-contracts account, the allocation of control among contingencies is not a concern of the account, but the efficiency of the allocation of control is. (Aghion & Bolton, 1992; Grossman & Hart, 1986) The key to the team-production account is that the board is not a representative of the shareholders, but a mediator between a number of separate, firm-specific investors, providing a different rationale for separating decision makers from any one stakeholder group (Blair & Stout, 1999).

Table 2. Competing normative accounts of founder control

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Account	Core claim	Prediction about persistence	Implied policy	Principal weakness
Idiosyncratic vision	Control protects unverifiable strategy from short-horizon capital	Value of control declines as performance becomes verifiable	Permit control; rely on private ordering	Does not specify when protection should end
Entrenchment / agency	Control that outlives its rationale enables extraction and insulation	Costs rise as controller cash-flow stake falls	Mandatory or default sunsets; voting caps	Understates the value destroyed by premature removal
Incomplete contracts	Control should be allocated to contingencies, not persons	Efficient allocation is state-contingent	Enforce contingent control transfer	Contingencies are hard to specify and verify ex ante
Team production	Board mediates among firm-specific investors	Insulation is justified while multiple constituencies invest	Strengthen board independence, not shareholder power	Weak account of accountability for the mediator
Empirical finance	Founder control relates to value non-monotonically and by stage	Premium early, discount at maturity	Calibrate by lifecycle	Identification is difficult; selection pervasive

Experimental evidence is not conclusive regarding this issue, and the fair conclusion would be that the link between founder control and firm value seems to be contingent rather than constant. Research on founder based chief executive officers (CEO) has found positive linkages between valuation and investment behaviour in certain samples and periods (Adams et al., 2009; Fahlenbrach, 2009), and research on dual class structures has found governance issues and value discounts that seem to deteriorate over time since listing (Cremers et al., 2018; Gompers et al., 2010; Masulis et al., 2009). The entrepreneurship conclusion, however, is a compatible one, but comes from the opposite perspective: entrepreneurs who have not given up control end up creating less valuable firms, where the decision is between throne and kingdom (Wasserman, 2017). This series of results is more in line with a stage-contingent optimal than with a more uniform prescription.

3.3 Control transfer in practice

In a large number of companies, founder control is not in fact permanent, and the ways in which it is given up provide information on the transition problem. The history of venture investing shows that the venture investor has historically been actively involved in the professionalisation process, often acting as the founder's replacement as CEO (Hellmann & Puri, 2002; Lerner, 1995). This is

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referred to as the founder-CEO succession paradox, and research on the subject describes it as a paradox of entrepreneurial success: for every milestone achieved, the odds of a founder-CEO change seem to grow, thus success leading to the loss of control that was sought after (Wasserman, 2003).

There are two characteristics of this pattern that are important for the framework. First, transition has historically been effected by exercise of the investor bargaining power at times of firm weakness or when the firm requires a lot of money, thus making it an unreliable and inappropriate mechanism because it works when the firm is weak, not when the gap is the largest. Second, the terms of funding have changed, making it easier to spread the private phase out longer, and that has also diminished the effectiveness of that mechanism because private founders can now choose to opt out of the governance of a new company when they fund it in a competitive environment. The transition problem has thus not only not been solved, it is more difficult to solve now with the private ordering that would solve it before.

4. Fiduciary Duty and Its Limits

4.1 The doctrinal structure

Directors of a corporation have a duty of care and a duty of loyalty, and good faith is considered a "subsidiary" duty of loyalty, not a separate duty (Stone v. Ritter, 2006). Prosecuting care: the duty of care is a procedural one, meaning that directors are only held liable if they failed to inform themselves before making their decisions; if they did inform themselves but made a bad decision, a failure to do so does not create liability (Smith v. Van Gorkom, 1985); the business judgment rule presumes that directors informed themselves and acted in good faith (Aronson v. Lewis, 1984); and in most corporations, exculpation provisions provided by statute eliminate monetary liability for care violations. As a consequence, the duty of care rarely imposes any obligation. The duty of loyalty is onerous, and bars the directors from engaging in self-dealing or pursuing interests adverse to the corporation, and this requirement has been revived in recent doctrine, when there are known mission critical risks that the board does not pay attention to (Marchand v. Barnhill, 2019).

A prior question is who these duties go to and it is contested in a manner that directly impacts entrepreneurial firms. The contractarian tradition considers the corporation to be a "nexus of contracts in which the fiduciary duty provides default terms that the parties would have bargained for, after which departures agreed upon by sophisticated parties should generally be honored" (Easterbrook & Fischel, 1991). The director primacy approach puts the final authority in the hands of the board, not the shareholders, and understands fiduciary duty as a limitation on an authority that remains very powerful and very real, in the hands of the board (Bainbridge, 2003). Critics of shareholder primacy contend that the obligation extends to the corporation as a business entity rather than to shareholders, and that the concept equating the corporation with the interests and wealth of shareholders is a theoretical error that has significant practical implications (Stout, 2012). In founder-controlled firms they differ markedly: In the contractarian interpretation, the contract is generally validated by the answer, while in the entity interpretation, it provides a foundation for limiting the answer.

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In addition to the rule on the business judgment, controlling shareholders also have duties, and transactions with a controller are subject to entire fairness, unless protective conditions are met, which include approval by an independent committee and by majority of the minority (Kahn v. M&F Worldwide Corp., 2014; Weinberger v. UOP, 1983). Jurisdictions vary significantly: Delaware has refused to develop special fiduciary rules for close corporations, indignant that the general law will suffice (Nixon v. Blackwell, 1993), while other jurisdictions, such as Massachusetts, have imposed duties directly upon the shareholders of a closely held corporation (Donahue v. Rodd Electrotype, 1975; Wilkes v. Springside Nursing Home, 1976). The approach of codified regimes is different: In India, for instance, directors' duties are expressed affirmatively in the statute, with duties to employees as well as to the environment, to the company and its members (Companies Act, 2013, s. 166).

4.2 Four structural limits of entrepreneurial firms

The following Table 3 outlines four reasons for this lack of performance in entrepreneurial firms that choose to be private enterprises. The first is an enforcement gap. Derivative and direct litigation to enforce fiduciary duties is available ex post, but requires a plaintiff with information, resources and a sufficient stake in the relationship. In private companies, the minority holders have only two of the three: they can't see the way the business is managed; they can't sell off to fund the claim; and their stake is too small to warrant the expense. If such a duty is present but cannot actually be enforced, it will not prevent behavior, and in some cases it might be better to have a duty and then design mechanisms that will enforce it, than simply to have no duty at all.

The second is the conflicted mandate. In a venture-financed company, directors appointed by preferred shareholders sit on the board of directors, which has a fiduciary responsibility to the company and its common shareholders, and preferred investors in a particular transaction may have opposing interests to common. Delaware doctrine has squarely addressed this, and has recognized that a transaction can be fair to common even when common receives nothing but still be in the interest of common (In re Trados, 2013). This answers the doctrinal question, but not the practical one: The directors who are required to apply the standard have the conflict.

The third is information deficit. Oversight liability assumes that a board is in a position to receive and respond to information. If the founder-CEO also chairs the board and controls the management reports, then the role of the board is informational and is what they are expected to be monitoring. Board monitoring capacity is an endogenous product of the control bargain, as empirical research on the evolution of boards indicates that they are systematically changing with the evolution and bargaining power of the firm (Ewens & Malenko, 2020).

The fourth is the disclosure void. Unlike public issuers, there is no periodic disclosure requirement for private companies, and the information preconditions used in external monitoring do not exist. Research on large private companies has singled this out as the problem that strikes center stage in the modern private market, in the sense that firms are now growing to scales for which the public-company rationale for disclosure is obvious but yet the companies remain formally exempt from the public-company regulatory regime (Fan, 2016; Pollman, 2019, 2021).

Table 3. Structural limits of fiduciary duty in private entrepreneurial firms

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Limit	Mechanism	Doctrinal source of the problem	Why it is not a doctrinal failure	What would actually address it
Enforcement gap	Duties enforced ex post by litigation minority holders cannot bring	Derivative standing, demand, and cost rules	Doctrine functions as designed; the plaintiff is missing	Ex ante information rights; fee-shifting; institutional plaintiffs
Conflicted mandate	Preferred-designated directors owe duties to common	Trados line of authority	Standard is coherent; its application is structurally conflicted	Independent directors with defined mandate at transactions
Information deficit	Board monitoring depends on flow controlled by the monitored	Caremark presumes an informed board	Oversight duty cannot manufacture information	Separation of chair and CEO; direct reporting lines
Disclosure vacuum	No periodic disclosure obligation for private issuers	Securities regulation scope, not corporate law	Corporate law was never the instrument for this	Scaled disclosure keyed to size and holder count
Care neutralisation	Business judgment rule plus statutory exculpation	Aronson; exculpation provisions	Deliberate policy choice to protect risk-taking	Accept; rely on loyalty and process design instead

5. The Fiduciary Gap and the Governance Regime Transition Framework

5.1 Defining the gap

We define the fiduciary gap as the difference, at a given point in a firm's development, between the monitoring need it generates and the accountability obligation actually enforceable against those who control it. Monitoring need is a function of scale, capital raised from parties who do not control the firm, the breadth of stakeholders bearing firm-specific risk, and the consequence of error. Enforceable accountability is a function of disclosure obligations, board independence and informational access, the practical availability of legal remedy to those harmed, and market discipline. Figure 1 plots these quantities across the firm's development together with the residual gap.

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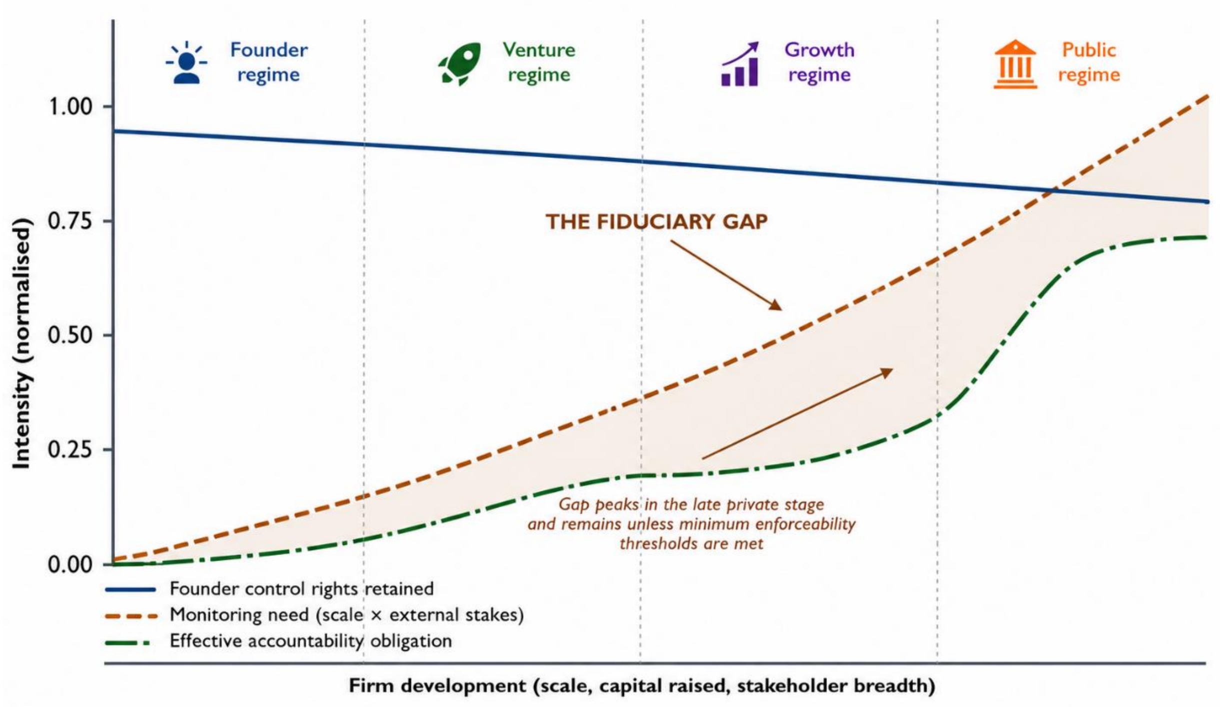

Figure 1. The fiduciary gap across governance regimes. Monitoring need rises with scale and stakeholder breadth; enforceable accountability lags and steps upward at public-market entry; founder control rights decline only slowly where charter devices protect them. The shaded region is the fiduciary gap, which peaks in the late-private stage.

The shape of the figure carries the argument. The gap is negligible in the founder regime because monitoring need is low. It closes sharply at public-market entry because accountability steps upward through disclosure, exchange listing standards, independent board requirements, and an active enforcement bar. It peaks in between. The late-private growth stage combines the monitoring need of a substantial enterprise with the accountability architecture of a small private one, and firms now occupy this stage for far longer than the framework of corporate and securities law anticipated when the boundary between private and public was drawn.

5.2 Four regimes and their transitions

Table 4 specifies the four regimes, their coherent internal logic, the triggers that signal transition, and the characteristic failure of remaining too long in each. The framework's central claim is that each regime is appropriate to its conditions and that failure is a matter of timing rather than of regime choice.

Table 4. Governance regimes, transition triggers, and characteristic failures

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Regime	Coherent logic	Dominant agency relationship	Transition trigger	Characteristic failure of overstay
Founder regime	Control fused with ownership; speed and vision protected	Effectively none; identity of interest	External capital from non-controlling investors	Informality persists into a capital structure that cannot tolerate it
Venture regime	Contingent control; staged capital; investor board seats	Founder-investor (Type I)	Employee equity base and stakeholder breadth widen	Preferred-common conflict governs while common is unrepresented
Growth regime	Professional management; independent directors; formal reporting	Controller-minority (Type II)	Scale, capital raised, and error consequence reach public-company magnitude	Peak fiduciary gap; oversight failure; concealment of adverse information
Public regime	Disclosure, market discipline, independent board, enforcement	Dispersed shareholder-manager	Not applicable	Perpetual dual-class insulates control from every mechanism in the regime

5.3 Propositions

Seven propositions follow. They are stated to permit testing with data that could realistically be assembled from filings, financing documents, and firm outcomes.

Table 5. Propositions of the Governance Regime Transition framework

Proposition	Statement	Theoretical warrant	Focal constructs
P1	The optimal intensity of founder control is stage-contingent and declining, so that the same control level is value-increasing early and value-decreasing late.	Verifiability erosion; idiosyncratic vision	Control intensity; stage; firm value
P2	Governance failures cluster where the fiduciary gap is widest, that is, in the late-private stage, rather than where founder control is highest.	Fiduciary gap construct	Gap magnitude; incidence of failure events

Proposition	Statement	Theoretical warrant	Focal constructs
P3	Reversibility of control devices, not their initial strength, predicts governance outcomes, because irreversible devices cannot track declining optimal control.	Transition mistiming	Device reversibility index; outcome measures
P4	Time-based sunsets outperform both perpetual control and event-based sunsets, because the triggering variable is observable and non-manipulable.	Contract verifiability	Sunset design; gap trajectory
P5	Fiduciary litigation frequency in private entrepreneurial firms is uncorrelated with the underlying incidence of duty violations, because standing and information constraints dominate.	Enforcement gap	Violation incidence; suit incidence
P6	Board informational independence predicts oversight outcomes more strongly than board compositional independence.	Caremark; information deficit	Reporting lines; committee access; oversight failures
P7	Employee equity holders bear a disproportionate share of the residual risk created by the gap, because they hold illiquid claims with neither control nor information rights.	Third agency relationship	Equity compensation base; realised outcomes

6. Closing the Gap: Design Instruments

If fiduciary doctrine cannot close the gap ex post, the instruments must operate ex ante. Table 6 organises them by the transition they are intended to manage. Three design principles cut across the table.

Table 6. Design instruments by transition

Instrument	Transition managed	Mechanism	Locus of adoption	Principal limitation
Time-based sunset on super-voting rights	Growth to public	Control lapses on a fixed, observable date unless reapproved by disinterested holders	Charter; exchange listing standards	Date is arbitrary relative to any given firm's verifiability path

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Instrument	Transition managed	Mechanism	Locus of adoption	Principal limitation
Ownership-threshold sunset	Growth to public	Control lapses when the founder's economic stake falls below a threshold	Charter	Threshold can be managed through structuring
Independent director with defined mandate	Venture to growth	A director owing duties solely to common, appointed at a defined round	Voting agreement; charter	Independence is difficult to sustain against the appointing bargain
Separation of chair and chief executive	Venture to growth	Board agenda and information flow cease to be controlled by their subject	Bylaws; board resolution	Frequently resisted; weak where the founder retains vote control
Scheduled information rights for common	Venture to growth	Periodic financial and material-event reporting to all holders	Shareholder agreement; charter	Costly to administer; confidentiality objections
Scaled disclosure keyed to size and holder count	Growth to public	Disclosure obligation attaches to economic significance, not listing status	Securities regulation	Regulatory reform is slow; jurisdictional arbitrage
Independent committee at conflicted transactions	Venture to growth	Preferred-common conflicts routed to disinterested decision-makers	Board practice; charter	Committee independence is itself endogenous to control
Secondary liquidity with disclosure conditions	Growth	Employee holders can exit, with information conditions attached to the market	Company policy; platform rules	Selective liquidity can entrench information asymmetry

The first rule is that, "observability is better than accuracy. A sunset that is based on an arbitrary date that can be observed, but not manipulated, by the party subject to the sunset is stronger than a sunset based on a theoretically superior variable that is manipulable by the party subject to the sunset. The reason the sunset debate has come to a focus on time-based formulations despite their obvious crudity is the substance of P4 - which is that it explains it.

The second is that information rights are prior to control rights. All of the other instruments in the table assume that somebody outside the control bloc is aware of what is going on. In the absence of information, independent directors are unable to make independent judgments, minority shareholders are unable to assert any duties that they cannot see the other party failing to perform,

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and there is no factual basis for the oversight liability. Information rights are also the least expensive right to be conceded at the negotiation table, because it does not give up control, making it the most malleable reform in the private-ordering context in which the majority of this governance is actually set.

The third is that the transformation should take place at a moment when it is not needed but when the power to transform is available. The most important time for independent oversight is when the firm is successful, when the founder has the greatest bargaining position. The only instruments likely to withstand the transition they are intended to manage are those that are triggered automatically as defined by a specific event, agreed during a financing round in which there is actual investor leverage.

7. Analytical Protocol

7.1 Simulation harness

The two of the framework's assertions have to do with functional form and comparative dynamics rather than sign and therefore should be shown, not asserted. The declared parameters of the simulation harness are given in figure 2. In P1 terms, the net governance cost is modeled as the sum of value forgone due to lack of protection from idiosyncratic vision and value destroyed due to entrenchment; the weights of these costs change with the stage, and will be decreasing in the control intensity inside the curve, as the firm matures, shown in panel (a). P4 is depicted in panel (b) as the fiduciary gap over time for three sunset designs: perpetual control has an open gap, a time-based release has a gap that is closed after a period of time, and a threshold-based release has a gap that is closed once a threshold is met. The parameters and the estimation template are recorded on table 7. There are no estimates of the parameters; rather, the figure exemplifies the behavior of the model and does not necessarily imply anything about the behavior of a population of firms.

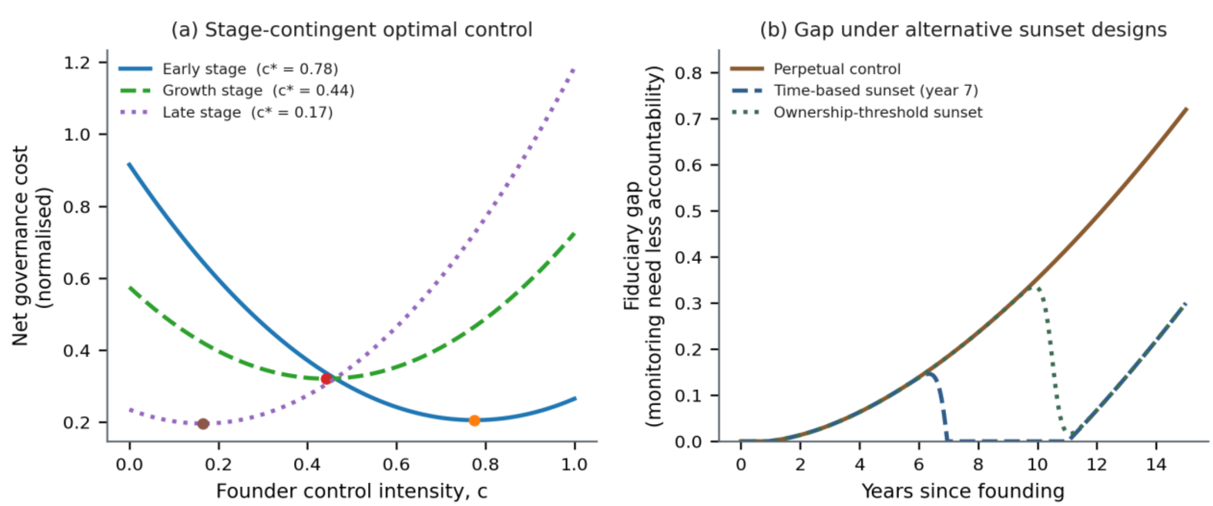

Figure 2. Panel (a) net governance cost as a function of founder control intensity at three firm stages, with the interior optimum marked. Panel (b) fiduciary gap trajectories under perpetual

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control, a time-based sunset, and an ownership-threshold sunset. All values are generated from declared parameters and illustrate model behaviour only; they are not empirical estimates.

Table 7. Simulation parameters and estimation template with placeholder notation

Element	Specification	Declared value or placeholder	Role
Vision weight	Value of protected idiosyncratic vision, declining in stage	1.0 less 0.85 times stage index	Pulls the optimum toward high control early
Entrenchment weight	Cost of insulated control, rising in stage	0.15 plus 1.15 times stage index	Pulls the optimum toward low control late
Cost curvature	Quadratic penalty on deviation from the stage optimum	Quadratic in both terms	Generates an interior optimum
Monitoring need path	Convex growth in scale and stakeholder breadth	0.12 plus 0.88 times normalised age raised to 1.6	Drives the gap
Accountability release	Logistic step at the sunset trigger	Magnitude 0.42; trigger at year 7 or year 10.5	Distinguishes sunset designs
P1 test	Firm value regressed on control intensity interacted with stage	Interaction [b1]; optimum [c*]	Rejects a uniform prescription if the optimum shifts
P2 test	Failure-event incidence regressed on estimated gap magnitude	Coefficient [b2]	Tests location rather than level of control
P3 test	Outcomes regressed on a device-reversibility index	Coefficient [b3]	Distinguishes reversibility from strength
P4 test	Gap trajectory compared across sunset designs	Contrast [b4]	Requires charter-level coding of sunset terms
P5 test	Suit incidence regressed on independently estimated violation proxies	Correlation [b5], expected near zero	Tests the enforcement gap
P6 test	Oversight outcomes on informational versus compositional independence	Coefficients [b6i], [b6c]	Informational measure expected to dominate

Element	Specification	Declared value or placeholder	Role
P7 test	Employee equity outcomes by gap magnitude at grant and at exit	Coefficient [b7]	Requires cap-table and outcome linkage

7.2 Measurement cautions

Four cautions apply. Survivorship is extreme: banks that have been eliminated from the most widely used data sets are also the ones with the worst governance performance, and so reported governance-performance links in samples of surviving banks are likely to be biased and in an unknown, but probably favourable direction. Selection is also very strong: founders that remain dominant are distinctly different from those that do not, and comparisons between controlled and non-controlled firms are confounded by the fact that this effect is due to both the control arrangement and the characteristics of the founder and the quality of the firms. This is also the case for endogeneity of the board, where board composition is a result of the bargaining position, which in turn shapes other governance features (Ewens & Malenko, 2020). Lastly, the fiduciary gap is an abstract concept, and must be expressed in an explicit measurement model (and not assembled into an ad hoc index) and its components must be explicitly validated separately before combining.

8. Discussion

8.1 Theoretical implications

The main thing the framework accomplishes is to shift the founder-control discussion to a question of timing. Put simply, there are two mutually incompatible perspectives (the idiosyncratic and the entrenched) and the literature has generated a series of 20 years of arguments in which each perspective is convincing about the period it studies. They are complementary, when said in a temporal sense, that is control protects an unverifiable vision and verifiability is low, and insulates against accountability when it is not, and the governance question is: When does the switch happen? How can it happen automatically, without having to negotiate at the worst time? The second is a division of labour between corporate law and securities regulation. But much of the criticism directed at fiduciary doctrine in this context is misdirected, for it is asking corporate law to do what it has never done—provide information to parties outside the control bloc—and to do it for a purpose that it was not designed to do, namely for the benefit of parties outside the control bloc. Based on the analysis in Section 4, my answer is informational and disclosure keyed to economic significance is the right instrument, a theme that is growing in scholarship regarding large private companies (Fan, 2016; Pollman, 2019).

The third implication relates to the third agency relationship. The position of employee equity holders does not seem to be well captured by either of the two frameworks of shareholder-primacy or team-production, as they carry firm-specific risk without control rights, and in the private stage have no meaningful information rights or exit. P7 says this is a claim that can be tested, and it proposes a constituency is being under-represented in a governance literature that is focused on investors and managers. A fourth implication is comparative. Concentrated ownership with

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attendant controller-minority conflict is the norm in the world, and the entrepreneurial firm is in this respect closer to the typical firm globally than the typical public corporation that the Anglo-American theory is built on (Shleifer and Vishny, 1997). Empirical studies on family businesses have identified that the impact of concentrated ownership on the performance of a family business varies depending on the type of control used (management control, control-enhancing devices, and intergenerational control) and that control-enhancing devices are not performed as favourably as management control (Villalonga & Amit, 2006). This literature and the start-up governance literature have evolved almost independent of each other despite the fact that they share the same structural problem, the question of whether the control arrangement still reflects conditions that support it (Fama & Jensen, 1983; Zingales, 2000).

8.2 Practical implications

To founders and boards, the "takeaway" is that transition instruments should be put in place before they are required, at the time of the financing, when they can still be negotiated, and should be activated automatically based on observable events. The implication for investors is that initial control allocation gets more attention than it would deserve had it not been for the possibility of reversibility: a good but reversible deal is better for investors than a bad but permanent one. To policymakers, it means that the cost of reform effort applied to fiduciary standards will be less than the cost of reform effort applied to disclosure thresholds, and less than the cost of the practical availability of remedy doctrine does not cause the failure.

8.3 Limitations

There are three restrictions that must be clearly expressed. This is a conceptual and doctrinal paper: the propositions are only derived and not tested, the simulation is internally consistent, not corresponding with an empirical population, the parameters are declared and Figure 2 is not to be read as an approximation. Second, the doctrinal analysis is based primarily on Delaware corporate law, with some reference to other jurisdictions, as this is a developing area and the actual scope of the reasoning of any particular decision may be broader than it appears in the text. Thirdly, characterisations of the empirical finance and entrepreneurship literature can be made that are descriptive and specify direction but do not give numerical estimates; readers should refer to the cited studies for numerical estimates, and should note that such identification is difficult in this literature because of the reasons set out in Section 7.2.

9. Conclusion

Corporate governance scholarship inherited and entrepreneurial firms do not give rise to a problem that is the separation of ownership from the control. What they offer, instead, is a problem of sequence: one that works at a small firm that is opaque, and whose stake is held by those who chose it; but one that fails at the consequential, large firm when the stake is held by those who did not choose it. The condition that results from this, the fiduciary gap, is what is named and the framework developed here sees the problem as one of mistiming the transition rather than of founder control per se. It's not likely to happen through the fiduciary doctrine. The duty of care has been knowingly undermined, the duty of loyalty is non-existent in a typical privately owned company and directors in a venture-financed company are caught between two conflicting duties that the doctrine has identified but not overcome. What is left is design: the giving of information

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rights up early, control mechanisms engineered to expire on observable events and disclosures to be made based on the state of a company rather than the fact that it is listed. The seven propositions and the analytical protocol presented here are designed to enable this argument to be tested, rather than merely believed, that is, refuted..

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