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**Do venture capital firms eliminate incumbent management teams?**

30/11/2005. Source:First Capital Group. Jeffrey P Blanchard

**Entrepreneurs and their management teams approach venture capitalists to fund not only their ideas, but also their approach to executing their schemes. One doubt that nags at many, however, is that the venture capital firm will use their financial leverage to terminate the founding management team, replacing them with the venture capitalists' personal choices for successors.**

**Do venture capitalists ever eliminate the extant management team?**

Only when necessary to serve the best interests of all of the company's shareholders. Partial changes to the team are generally initiated by the extant management team and tend to reflect upgrades as the company grows and evolves. Occasionally, changes may be initiated by the by the venture capitalists and/or the board of directors when things have gone terribly awry and a change is necessary to preserve shareholder value and the venture capitalists' investment value.

When a company's life cycle is examined, it's clear that some managers' skill sets are best suited to managing a particular segment of that cycle, rather than being appropriate for the company's entire life-cycle. For example, a specific manager may excel at launching to the \$1 million to \$20 million level, but another type of manager may be required to run the company as sales grow beyond that range.

A venture capitalist serving on a portfolio company's board of directors bears fiduciary responsibility to that firm's shareholders which may require filling in critical voids in the team's structure or replacing an underperforming member of the team as a safer alternative to replacing the entire team.

There have been several instances over the past 20 years where a key member of a management team was not performing as required. Examples have included chief financial officers, chief technology officers, and heads of sales as often as chief executive officers. More often than not, the rest of the team acknowledged the need for the change and viewed it as a positive occurrence.

When changes become necessary for shareholders' best interests, founders and management companies continue to retain the vested stock or options they held at the time they are removed. We're making decisions to benefit the shareholders at large; it's reasonable that the existing stakeholders will benefit from such decisions as well.

Changes to entire management teams, then, are highly unusual occurrences; partial changes, while more common, are never made without careful consideration of the impact of such change on the organization and shareholder value. This is because nearly all investment decisions are made based in large part on the investor's belief

that the management team presenting the investment opportunity can capably execute their business plan. The investor believes this team will create value, ultimately allowing the venture capital firm to exit with a successful ROI.

Entrepreneurs concerned about the possibility of a forced management turnover can relax a bit by educating themselves about the due diligence process.

The typical deal, from the first look at the business plan to the initial funding, averages 4-6 months while the average holding period of an investment may range from three to seven years. Given this lengthy timeframe, venture capital firms are loathe to invest quickly, preferring instead to use a stringent process of due diligence that relies on an exhaustive evaluation of the management team.

Our own due diligence process includes assessments of the management team's references, including "back channel" references not included on the lists supplied by management team, the source which referred the team to us, and the impression that suppliers, past partners, and sales channels have of this team.

This process is both quantitative and qualitative. We ask: Is the management team appropriately committed to the business, as measured both in terms of their emotional as well as their financial commitment to the company. We seek managers for whom failure is not an option because their financial and emotional commitments are palpable. Finally, we tend to engage deals that come to us through highly credible referrals who vet the deals they send, adding another layer of diligence to our process.

Thus, before the first check is cut, we know whether this management team possesses the correct objectives, experiences, passion, cerebral capacity, commitment, and ethics for us to risk investing in them.

Few--very few--companies make it through a good venture capitalist's due diligence process. In our case, we fund about one-half of one percent of the deals we consider annually. But of those funded, we--and most venture capital firms--trust that the management team we funded has the right stuff to run their company.

***First Capital Group*** is a venture capital firm that invests in a diversified portfolio of well-managed early- and expansion-stage companies primarily in Texas and the Southwest, working with their management teams to help build value. As one of Texas' most established venture capital firms providing funds to this traditionally under-served market segment, First Capital Group delivers more than 75 years' combined experience to assist entrepreneurs in obtaining the capital they require to execute their business plans and the experienced counsel they need to help achieve their business objectives.

*Jeffrey P. Blanchard launched the San Antonio-based firm in 1984, having already held senior management positions in two other such firms. First Capital Group has consistently remained focused on a diversified investment strategy, enabling it to meet investors' needs for a lower-risk portfolio without compromising expected investment returns. First Capital Group originates and serves as a lead or principal investor in all of its transactions. For more information visit [www.FirstCapitalGroup.com](http://www.FirstCapitalGroup.com)*