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## CASE FOR SECTORS

## SECTOR ANALYSIS

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### The advantages of investors sitting on the boards of their portfolio companies

09/11/2005. Source:First Capital Group. Jeffrey P Blanchard

**Entrepreneurs often fear that investors will micromanage their company, usurping the responsibilities of the extant management team and imposing the venture capitalists' will. As with many longstanding and prevalent concerns, this one contains some validity, but much more mythology.**

Let's begin by considering the mythology that venture capitalists will want to direct the management team to an inappropriate extent. Venture capitalists ultimately back management teams, not ideas. If we didn't think the management team could do a better job of executing the business plan than we could, we would be well advised not to make the investment, period.

That said, it is true that venture capitalists must occasionally play an active role in running the investment company. These rarities are brought about by management teams that are under-performing and failing to meet expectations.

I want to emphasize that this scenario is exceptional. Indeed, in 25 years as a venture capitalist, I have only had to step into operating positions in two portfolio companies, and only for as long as it took to resolve the issue that led to that degree of involvement, or to hire successor management.

In one instance, the board of directors of one of our portfolio companies chose to terminate the company's CEO for repeated failure to follow the agreed-upon business plan, even in the face of admonishments and explicit directions from the board. Following the CEO's termination, I stepped in as the interim CEO to work with the rest of the management team. After a six-month evaluation, an existing member of the management team was selected as the new CEO and I quickly phased out of any day-to-day responsibility at the company.

This exemplifies how we had originally backed a "management team" rather than any single individual and acted to remove the old CEO only when it became necessary to protect the value of the company by acting in what we considered to be the best interests of all of the company's shareholders. We further confirmed our confidence in the management team that we had originally backed by selecting a member of that team to serve as the new CEO.

While I hope never to have to manage a portfolio company again, this experience has placed my firm in the unique position of being better able to relate to and to empathize with the challenges faced by the standing management team.

**How much control do venture capital firms really desire?**

Venture capital firms routinely and consistently seek enough ownership in a company to contribute a meaningful voice, and enough of a stake in the company to justify spending more time helping the management team on an as-needed basis to help create value. At a minimum, a venture capital firm will want to own enough of an ownership position to justify or warrant the right to a board seat.

Indeed, in my firm, we sit on the board of every one of our portfolio companies. Why? Because of the experience and attendant benefits that we can bring to those companies.

### **What benefits can you, the entrepreneur, expect from allowing your investor a seat on your board?**

The management team's full-time job is to run the company; their focus tends to be more tactical, which, while necessary, can occasionally lead to the loss of focus on strategic objectives. When your investor sits on your board, that person can be invaluable in the areas of strategic planning, capital formation, recruitment of additional members of the extant management team, and playing an active role in the development and the execution of exit strategies.

Many closely held companies desire to recruit qualified outside directors, an important task that can be a very difficult proposition, particularly in the litigious world we inhabit. An outside director with great field experience and an extensive Rolodex can open many doors in the market segment in which a given company operates. However, it's not always possible to locate such people and convince them to join your board.

In the absence of the seasoned industry executive willing to serve, a venture capitalist--particularly one with experience investing in the company's industry or market segment--may be able to bring much of that desirable industry knowledge, contact base, and ability to open doors. Moreover, the venture capitalist also brings considerably more experience than the average board member in the areas of strategic planning, capital formation, recruitment of additional personnel, and development and execution of exit strategies.

In conclusion, although the fear is that venture capital involvement can be to an entrepreneurial enterprise's detriment, appropriate involvement as with a board seat is actually to the management team's advantage. Frequently, problems encountered by many emerging and growing businesses have been addressed by the investor in a prior investment, particularly when the venture capital firm is one of long standing. In this sense, the investor can act as a trusted advisor, helping the management team to avoid pitfalls that would otherwise encumber their growth.

Venture capitalists seek to add value to your business through contributing not only funds, but also a voice in the venture capitalist's areas of expertise. Wise entrepreneurs can welcome this involvement without trepidation.

***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

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