Exploratory Note 14

VC Value Added and the Monitoring of Portfolio Firms

**INTRODUCTION**

Venture capital firms are usually expected to do more than simply invest money. Though capital is critical, so are a host of other tangible and intangible value adds.

**VC VALUE ADDED AND THE MONITORING OF PORTFOLIO FIRMS**

VC value adds come from a variety of functions performed by them (many of which double as monitoring mechanisms) including: board representation, corporate governance, human resources, matchmaking, and strategy.

***Board Representation***

Holding one or more seats on the board of directors is a key mechanism for VC monitoring. Why is the board of directors so important? What do VC have to add?

On what types of issues does the board have say?

A major point of contention that can and does arise is whether or not the founder of startup should be replaced with a professional manager once the firm achieves a certain level of success. Peter Drucker argues, “there is entrepreneurial work and there is managerial work, and the two are not the same.” What do you think?

Further, there is an argument to be made that a shift from “passionate commitment” to “dispassionate objectivity” is needed once a firm becomes established. What do you think?

Historically, have founder-CEOs performed worse than professional-CEOs?

***Corporate Governance***

Corporate governance rules define the power-sharing relationship between shareholders and managers. Though governance is a controversial area (which we will explore during the last two sessions of the course), the best time to set good rules is while a company is still small and before it goes public. Interestingly enough, the historical record supports the following associations when it comes to VC-backed firms:

* They are less likely to engage in aggressive accounting prior to an IPO;
* They are more likely to have independent boards and board subcommittees;
* They are more likely to separate the roles of CEO and Chairman.

***Human Resources***

VCs spend a large amount of time working on human resource issues at their portfolio companies. Can the reputation of a VC assist a firm in attracting top talent? If so, why? Is VC money a notable signal?

Scholarship suggests that VC-backed firms are quicker to hire senior executives (such as a VP of Marketing) and adopt stock option plans. What are the potential benefits?

How important are human resources issues to startup firms?

***Matchmaking***

VCs often use their contacts and reputation to make introductions that can lead to new partnerships, customers, and suppliers. Are VCs prone to pushing relationships between their own portfolio companies?

***Strategy***

When it comes to strategy, VCs play a material role. Consider, for instance, the matter of exit. What does a VC have to add relative to the entrepreneur or most (if not all) participants in the organization?

Some VCs are generalists while others are specialists. What is the difference? How will the advice of both differ?

**CONCLUSION**

High-growth firms are difficult to manage due to a combination of rapid growth, feelings of infallibility, internal turmoil, and inevitable resource needs. VCs are not able to eliminate these problems; however, their resources and experience do much to strengthen a firm’s ability to thrive within such an environment.