larcen consulting group

October 2006

larcen vision

THE BOARD MANAGEMENT ISSUE

larcen's lessons

WHAT'S TRUST GOT TO DO WITH IT?

By Dell Larcen

Elsewhere in this edition of *LarcenVision,* you will find useful advice on best practices for good board governance from those who have been on the playing field. This month we focus on investor boards, and the November newsletter will explore the topic from the perspective of public boards. But one issue traverses both boards – the issue of trust.

Both in teams at the top and in board-CEO teamwork, the most elusive dynamic in the cauldron of decision-making is that of trust. And the presence – or absence – of trust will eventually become the most fundamental predictor of the quality of leadership provided by any group of executives charged with stewardship of a company. And yet, seldom do you see such groups grapple with this tough issue. Even as they see evidence of blatant disrespect and distrust, the informal pressures assure that the lack of trust goes underground and that the appearance of civility is maintained at all cost.

So what happens to decision making in such an environment? Inevitably an artificial consensus will emerge behind which brews discontent and non-alignment. This can certainly spark any number of dysfunctional behaviors – the most recent public display being, of course, the HP scandal.

The board has two fundamental responsibilities – to assure a viable long term strategy and to be diligent that management is doing the right things to create a robust and viable enterprise. But any group of smart leaders will inevitably have different experiences and perspectives to bring to these discussions. It is how these differences are managed that will characterize a true team.

Really good boards create a culture of open debate and dissent; they know that this is their ultimate responsibly – to speak their minds and really "listen" to their peers as they do so. In this culture, it is expected that critical thinking about strategy and management's approach will be welcomed. There is a clear understanding that these challenges are not personal, and that differences of view as to task decisions do not

continued on page 2

Quotable Quote

"Be careful how you judge others…. As Scottish author J.M. Barrie said, 'Never ascribe to an opponent motives meaner than your own'…. We tend to judge others based on their behavior, and ourselves based on our intent. In almost all situations, we would do well to recognize the possibility – even probability – of good intent in others… sometimes despite their observable behavior."
– Stephen M. R. Covey in *The Speed of Trust*

Recommended Reading:

The Speed of Trust: The One Thing that Changes Everything by Stephen M. R. Covey, Free Press, 2006.

continued from page 1

need to undermine personal relationships and will ultimately help to grow the level of trust. As James Surowiecki indicated in the October 9 edition of the *New Yorker,* "Good decision-making groups engage in 'task conflict,' fighting over the best solutions to particular problems, while bad ones engage in 'relationship conflict,' interpreting differences of opinion as differences of character."

Our firm is frequently asked to intervene and help teams manage beyond the personal conflict and to create a more constructive decision dynamic with the group. Sometimes this is called team building. But this is not the work done on ropes courses and white water rapids. This is the work that requires real dialogue about how the board will conduct its business and by what rules it will hold itself accountable. It becomes the first real lesson in "listening" and in surfacing conflict in a healthy and productive manner.

Without this agreement as to how to manage decision making, the ultimate stewardship of the board – or any team for that matter - will be sub-optimized. Distrust only breeds other very unwanted behaviors that will undermine the real opportunity of the enterprise.

Next month we will explore those factors that can lead to distrust in any group and how to manage them.

BUILDING A SUCCESSFUL VC BOARD
Interview with Pascal Levensohn

The leaks at Hewlett-Packard and subsequent investigation into board members have sparked nationwide reflection and discussion on the nature of boards, and the potentially volatile and precarious dynamics that can go on behind closed doors. *LarcenVision* spoke with Pascal Levensohn, founder and managing director of Levensohn Venture Partners and author of several articles on corporate governance, about the role of a venture capital-based board, the troubles they may encounter, and what they need to do in order to succeed.

LarcenVision: What is the role of a board in a start-up? Is it operational, advisory, monitoring?

Pascal Levensohn: At the highest level, how much value does a board really have? Relative to the value added by a great CEO, the board adds less value – but a dysfunctional board can take away value more than any CEO. A high-functioning board can add value by monitoring and anticipating strategic and operational issues. A board of directors should have a broader experience set than the entrepreneurs, and should be able to allow management teams to shortcut the painful process of learning by trial and error. In addition, investor directors should help companies in terms of assessing the competitive landscape and product and marketing strategies and by closing business. An active venture investor is not a passive check writer.

LV: That sounds very different from a public board.

PL: One interesting point of distinction is that in the new regulatory environment, the rules for behavior in public companies discourage active involvement in the strategic direction and strategic operations of the company. I know some high profile VCs who have left public boards because they can't do what they do best.

LV: What are some of the most often cited frustrations you hear from board members?

continued on page 3

continued from page 2

PL: The number one frustration from the board is lack of communication. The number two frustration is a lack of understanding of best practices. There is still much too much done in venture boardrooms on an *ad hoc* basis, figuring it out on the fly, not stepping back and asking "Where can I turn to understand?"

LV**:** Isn't some of that seat-of-the-pants, *ad hoc* mentality intrinsic to the start-up environment?

PL: This "*ad hoc*-ness" is unique to VCs because, by definition, we're in the capital creation business, so we create more inexperienced directors than any other business that I can think of. It's the reality, so we should be addressing issues of basic director education.

LV: You write about the personality traits of good board members – that they should have emotional stability and strong interpersonal skills, the ability to recognize patterns and partner, and the ability to mentor the CEO, among others. Can these attributes be taught? Should you reject a board member because they don't have these traits or skills?

PL: Every partnership should optimize people who serve on boards. Board members aren't chosen by their personalities. Everyone has different talents. There are certain qualities that can make someone effective as a director. It means you should address those issues head on, not that they shouldn't be on the board. You can change the way you address the human dynamic on the board to be cognizant of the fact that people behave differently in different situations.

LV: What are some of the issues that CEOs typically struggle with in supporting their boards?

PL: One of the most interesting facts that I've seen is in a board survey conducted by the National Venture Capital Association in April of this year. When asked about the most common drivers of conflict, the number one issue cited by VCs was personality conflict with the CEO. The number two issue for VCs was exit strategy. The CEOs' number one conflict was valuations and number two was burn rate. What's striking is that personality conflict – the VCs' number one issue of concern – didn't even show up on the CEOs' pie chart. They really didn't know there was conflict with their board. That tells you volumes right there. It's a huge deal because it tells you how different the perspectives are. It gets back to what is the number one problem on a VC board – communication. People are not communicating well. There are many opportunities for misunderstanding and poor management of expectations.

LV: Are best practices and basic director education out there?

PL: That's one of the reasons I started a Working Group on Director Accountability and Board Effectiveness. It has 23 members from the industry, including CEOs, independent directors who serve on venture-backed and private boards, and prominent VCs. We're in the process of creating a document that concisely outlines the minimum expectations for board service in a VC-backed company and distinguishes between VC directors, management directors and independent directors. We're also addressing questions of accountability through best practices recommendations. Just because VC directors buy their board seats, it does not absolve them of their responsibility to be effective directors and to be accountable to their fellow directors.

TEN COMMON PITFALLS OF VENTURE BOARDS

In his white paper *After the Term Sheet: How Venture Boards Influence the Success or Failure of Technology Companies,* Pascal Levensohn and co-author Dennis T. Jaffe, PhD, describe ten of the most common pitfalls that VC boards can expect to face. The list can be a starting point for self-evaluation and dialogue.

1. **Complacency.** Complacent boards do not challenge the company. Monitoring and evaluating the tough issues facing a company is crucial.

2. **Inability to confront difficult issues.** Long-standing board members may be wedded to old ways of thinking. Are new perspectives shunned because there might be disagreement?

3. **Distraction, over-commitment.** Board members may be overcommitted or may have lost interest. An effective board member must be prepared and intellectually present and available.

4. **Lack of alignment of board members and investors.** Early and later investors may have different financial concerns that do not align. Any differences in agendas must be resolved in order to move forward.

5. **Divided Boards.** There is a difference between a majority and consensus. If the entire board is not in agreement, polarization can occur.

6. **Paralysis over liability issues.** In a dynamic VC environment, inactivity can be costly. Risk must be balanced with prudent action.

7. **Board member role confusion.** Board members with operating experience may overstep the boundary of their role. When this happens, the board leader and CEO must address it.

8. **Leadership vacuum.** In order to be effective, a board must have a clear leader who tackles the required tasks facing the board and makes sure the board is being utilized to its fullest.

9. **Loss of trust in the CEO.** Often stemming from poor communication, once trust is lost, the stage is set for factions, secrets and leaks.

10. **Resolution to fail.** If a clear path is not in sight, directors may begin thinking of an exit strategy instead. Once this mindset is in place, valid options for success may be overlooked.

TIPS ON CREATING A HIGH-FUNCTIONING VC BOARD

By Larcen Senior Consultant Jill Springer

Like any team or organization, a board of directors will have to deal with differing viewpoints, interests and work styles at some point during the course of their business affairs. And just like any organization, sometimes boards deal well with confrontation and other times egos and self-interests can get in the way.

One of the traps that I have seen in working with private boards, which are generally smaller and less formal than public boards, is that they can lack rigor in their early meetings. If you intend to go public with your company, you need to set the stage for the future. For each meeting, have a clear sense of what you're trying to accomplish. Have an agenda. Conduct formal meetings in person. I've seen companies where board members telephoned into meetings, which sends the wrong message. To me, that says, "Let us know when there's a problem and we'll deal with it face to face."

The other side of the coin is a board that wants to get too involved. They have lots of good ideas, and they have people in their firm they can send in to "fix" a problem. One day you look up and you have ten people on your advisory committee. While outside advisors can certainly benefit a company and help keep it from falling into "groupthink," as a small company, when you're trying to focus on your product, marketing and sales, you may not have the resources to manage all this "help." It can become a hindrance in some cases. As a CEO, you need to be skillful at managing that input.

After any board meeting, the CEO, CFO and any others who were in the room should debrief. Identify which views and issues different board members represent, and understand the dynamic that occurred in the meeting. Just like any other organization, a board of directors should invest in their own development and understand how they deal with information and conflict, in order to be more effective overall.

WHAT WE'RE READING NOW

"I'm reading *A Glass Castle* by Jeannette Walls, a regular contributor to MSNBC. It's a true-life story of resilience in the face of incredible dysfunction." – Larcen CEO Dell Larcen

"Right now I'm reading *Brag: The Art of Tooting Your Own Horn without Blowing It,* by Peggy Klaus. I want to help clients find compelling ways to present themselves. We tend to invest more time and creativity in marketing our products or services than in marketing ourselves. 'Self-promotion' may have a bad ring to it, but every interaction makes an impression, so we should study how to represent ourselves most effectively. I think this is a part of 'executive presence.'" – Larcen Senior Consultant Michael Popowits

"I'm reading *Authentic Happiness: Using the New Positive Psychology to Realize Your Potential for Lasting Fulfillment,* by Martin Seligman." – Larcen Senior Consultant Kent Chen

"Currently I am reading *The Last Word on Power* by Tracy Goss; *Weaving Complexity and Business* by Lewin and Regine; and *Building Trust in Business, Politics, Relationships and Life* by Robert Solomon and Fernando Flores."
– Larcen Senior Consultant Marcia Ruben