The Influence of Venture Capitalists on their Portfolio Companies: Exploratory Case Studies from Belgium

Nicolas De Vlaminck,
Louvain School of Management
Gerrit Sarens,
Louvain School of Management
The Influence of Venture Capitalists on their Portfolio Companies: Exploratory Case Studies from Belgium

Nicolas De Vlaminck, Louvain School of Management
Gerrit Sarens, Louvain School of Management

Summary

This paper examines the influence of venture capital activism on portfolio companies. Venture capitalists are seen as active investors who play a significant role in the development of entrepreneurial companies. Prior studies show that having a seat on the board of directors is the primary channel employed by venture capitalists to interact with their portfolio companies. However, we observe that past research on corporate governance lacks understanding on how boards of directors actually work and calls further research to focus on board’s behaviour. The literature underlines the importance of the role that each board member plays in contributing to board ability to add value to the company. We consider human capital plays as crucial in gaining better understanding of the relationship between venture capitalists and their portfolio companies.

In this paper, we review the literature on both boards of directors and shareholder activism. We contribute to academic research by providing more understanding of boards of directors functioning in young and growing companies backed with venture capital. We also provide insights on how venture capitalists behave on the board of directors and how human capital affects the relationship between venture capitalists and portfolio companies’ management teams. Given the lack of research in this area, we conducted an exploratory study based on in-depth interviews with a representative group of eight venture capitalists in Belgium. We find that venture capitalists are active in recruiting managers and board members, help with fundraising, contribute to the development of new activities and are involved in the selling of companies’ assets. We report that an observer position is most of time required when venture capitalists do not have a seat on the board of directors. We also observe that informal channels to exert an influence on decisions are as important as formal procedures. We confirm some previous studies findings on the relationship between venture capitalists and management and call into question boards of directors’ added value in the context of this study. In addition, our results suggest several avenues for future research.

Keywords: Venture Capital; Shareholder Activism; Board of Directors.

JEL Classification: G24, G30, M13.

Corresponding author:
Nicolas De Vlaminck
Center for Excellence CESAM
Louvain School of Management / Campus Louvain-la-Neuve
University catholique de Louvain
1 place des doyens, B-1348 Louvain-la-Neuve, BELGIUM
Email: nicolas.devlaminck@uclouvain.be
This paper examines the influence of venture capital activism on portfolio companies. Venture capitalists are seen as active investors who play a significant role in the development of entrepreneurial companies. Prior studies show that having a seat on the board of directors is the primary channel employed by venture capitalists to interact with their portfolio companies. However, we observe that past research on corporate governance lacks understanding on how boards of directors actually work and calls further research to focus on board’s behaviour. The literature underlines the importance of the role that each board member plays in contributing to board ability to add value to the company. We consider human capital plays as crucial in gaining better understanding of the relationship between venture capitalists and their portfolio companies.

In this paper, we review the literature on both boards of directors and shareholder activism. We contribute to academic research by providing more understanding of boards of directors functioning in young and growing companies backed with venture capital. We also provide insights on how venture capitalists behave on the board of directors and how human capital affects the relationship between venture capitalists and portfolio companies’ management teams. Given the lack of research in this area, we conducted an exploratory study based on in-depth interviews with a representative group of eight venture capitalists in Belgium. We find that venture capitalists are active in recruiting managers and board members, help with fundraising, contribute to the development of new activities and are involved in the selling of companies’ assets. We report that an observer position is most of time required when venture capitalists do not have a seat on the board of directors. We also observe that informal channels to exert an influence on decisions are as important as formal procedures. We confirm some previous studies findings on the relationship between venture capitalists and management and call into question boards of directors’ added value in the context of this study. In addition, our results suggest several avenues for future research.

Keywords: Venture Capital; Shareholder Activism; Board of Directors.

1. Introduction

Venture capitalists are seen to play an important role in the development of entrepreneurial businesses (Bygrave & Timmons 1992; Fried et al., 1998). Entrepreneurial firms targeted by venture capitalist are typically young and small, growing rapidly in an uncertain and changing environment. Prior literature widely recognized that venture capitalists contribute to the growth of their portfolio companies (Puri & Zarutskie, 2011). Venture capital funds management teams developed mechanisms to overcome issues that occur at each stage of the investment process and provide added-value services to portfolio companies (Lerner, 1995; Hellmann & Puri; 2002; Kaplan & Stromberg; 2004). Past research investigates the role of human capital on organisational performance and includes Gimeno et al. (1997), Pennings et al. (1998), Bertrand and Schoar (2003), Beckman et al. (2007), Kor and Sundaramurthy (2009) and Barroso et al. (2011). We consider that human capital plays a crucial role in gaining better understanding of the relationship between venture capitalists and portfolio companies. According to Bonini (2012), entrepreneurial businesses are closely related to human capital management at the time of venture capital investment. In this study, we consider the board of directors as the primary governance mechanism used by venture capital management teams to interact with portfolio companies (Sapienza, 1992; Lerner, 1995; Busenitz et al., 2004).

We build on past corporate governance research that focuses on boards of directors functioning (Daily et al., 2003; Davis, 2005; McNulty et al., 2005; Bailey & Peck, 2013). We observed a lack of knowledge on how venture capitalists influence their portfolio companies and contribute to this stream of research by providing more understanding of boards of directors functioning. Additionally, the study provides more insights on how individual venture capital funds management teams behave on the board of directors and how they interact with their portfolio companies. Huse (2005) argues that case studies are needed to meet some research questions related to board behaviour. We build on his work via in-depth cases studies on the influence of venture capitalists’ human capital on the board of directors. We conducted the study in Belgium, a country characterized by a large number of small businesses and a great amount of venture capital flowing to early-stage investments in comparison to other European Union members (European Commission,
De Vlamink, N. and Sarens, G. (2013). The Belgian context makes also rich contribution to shareholder activism research that has so far widely focussed on financial effects of activist actions on portfolio companies mainly within an Anglo-Saxon context (Gillan & Starks, 2007). Prior studies report that effects of shareholder activism outside that context still remain little examined (Ciccotello & Grant, 1999; Hernandez-Lopez, 2003; Poulsen et al., 2010).

Finally, we build on McNulty and Stiles’s (2005) and Petrovic (2008). First, McNulty and Stiles’s (2005) argue that researchers need to open the black box of actual board behaviour to develop more knowledge on how to create added-value for portfolio companies. They report that research needs to bridge the gap between board role expectations and actual board of directors functioning. Second, Petrovic (2008) stresses the need to make board members role more clear via a focus on individual board members attitudes, skills and behaviours. As a result, we concentrate on how venture capitalists representatives perceive the role of board of directors and how they exert influence on the board decision making process.

The paper is structured as follow. First, we carry out a review of the literature on both boards of directors and shareholder activism. Second, we present empirical methods and data. Third, we provide insights from case studies. The fourth section summarises and the fifth section provides avenues for future research.

2. Theoretical background
2.1. The board of directors
Most of past research in corporate governance has focused on board composition with foundations in agency theory (Huse, 2011). According to agency theory, the board of directors monitors management actions on behalf of shareholders (Fama, 1980; Fama & Jensen, 1983). Agency theorists argue that mechanisms must be put in place to ensure that management is closely monitored and that principal-agent conflict is mitigated.

2.1.1. The role of the board of directors
The board of directors plays three main roles: a service role, a monitoring role and a networking role (Zahra & Pearce, 1989; Goodstein et al., 1994; Johnson et al., 1996; Stiles & Taylor, 2001). First, the service role aims at giving advices while evaluating decisions proposed by management (Stiles & Taylor, 2001). Stiles and Taylor (2001) argue that this role is automatically established by the board of directors participating in the decision making process and in determining company’s strategy. Second, the monitoring role is consistent with agency theory and ensures that shareholders’ interests are safeguarded (Fama & Jensen, 1983; Shleifer & Vishny, 1997). To perform this task, the board of directors examines company’s performance and the implementation of management actions (Zahra & Pearce, 1989; Johnson et al., 1996; Stiles & Taylor, 2001). Desender et al. (2013) show that the monitoring role is essential when ownership is dispersed. However, the board monitoring function is smaller when ownership is concentrated (Desender et al., 2013). Third, the networking role ensures that the company has access to external resources (Pfeffer, 1972). For example, board members may provide inter-firm relationships to develop sales or make contact for acquisitions or business development. According to Zona and Zattoni (2007), the effectiveness of the service role, the monitoring role and the networking role is influenced by different processes within the board of directors.

2.1.2. Board of directors’ processes
Processes include cognitive conflict, effort norms and the use of knowledge and skills (Forbes & Milliken, 1999). Cognitive conflict refers to differences in judgment among board members. Jehn (1995) defines cognitive conflict as divergence of opinion about tasks to be performed by board members. This plays a key role as the board of directors should include members sharing different views and opinions that are taking together complex decisions (Dutton & Jackson, 1987). Effort norms are members’ expectations on the amount of effort and time to devote to her or his duty (Wageman, 1995; Zona & Zattoni, 2007). Effort norms exert a strong influence on group member behaviour and are particularly relevant in groups like boards of directors according to Wageman (1995). The use of knowledge and skills allows board members to influence company’s decision making process. Board tasks are divided among members based on expertise and processes to transfer information to other members are put in place (Finkelstein &
De Vlaminck, N. and Sarens, G. (2003). Both the presence and the use of knowledge and skills are important for a board of directors to function effectively. This means that knowledge and skills must be made available and be applied to relevant tasks. Finally, Zona and Zattoni (2007) show that the use of knowledge and skills has a positive impact on the board of directors’ monitoring and service roles.

The extent to which the board of directors carries out its monitoring role is not constant but changes over time and depends on information the board of directors obtains from management (Hillman et al., 2008; Ocasio, 1997). Tuggle et al. (2010) show that shareholders’ interests are defended depending on the contextual firm situation. They suggest that less attention will be paid to monitoring in presence of CEO duality and if previous performances are good. Walsh and Seward (1990) find that past performance is crucial as it has an impact on the perception of the tasks carried out by management. When a company performs well, management is considered more efficient and less importance is given to the monitoring function. On the other hand, poor previous results damage reputation of board members and push the board of directors to pay more attention to its monitoring role (Fama, 1980; Fama & Jensen, 1983). According to Lorsch and Clark (2008) and the Belgian Corporate Governance Code (2009), it is important that the CEO and the chairman of the board of directors is not the same person to ensure the pursuit of shareholders’ interests. Otherwise, the work of independent board members would be guided by the CEO (Rechner & Dalton, 1989; Baliga et al., 1996). The Belgian Corporate Governance Code (2009) advises the board of directors to be chaired by a non-executive board member to ensure independence from the CEO. Finkelstein and D’Aveni (1994) report that CEO duality affects interactions between board members. CEOs who sit on the board of directors have a tendency to reduce the monitoring function (Walsh & Seward, 1990; Desender et al., 2013).

2.1.3. The composition of the board of directors

To be able to play its role, the board of directors relies on expertise and experience of its members. However, the composition of the board of directors is not clearly defined in the literature and varies across studies (Raheja, 2004; Boone et al., 2004). The Belgian Corporate Governance Code (2009) provides a number of recommendations. First, the code states that the board of directors should be composed of both executives and non-
executive board members. Furthermore, all board members should demonstrate independence of judgement and objectivity in making decisions. An independent board member will play a key role in this respect. Executives are insiders and non-executive are shareholders representatives or independents that sit on the board of directors. Board independence is widely advocated under agency theory. Wagner (2011) argues that members’ independence should create a more efficient board and ensures more effectiveness as independent members strongly stand for the protection of shareholders’ interests. However, empirical evidence is mixed with regards to the importance of board structure to assure governance effectiveness (Dalton et al., 1998; Rhodes et al., 2000). We find that the composition of the board of directors depends on the context and national characteristics (Markarian & Parbonetti, 2007; Li & Harrison, 2008). Sur et al. (2013) show that boards composition is highly dependent on the company’s ownership structure. Further, Charkham (1994) and La Porta et al. (1999) report that ownership structure is an important factor which varies in function of firm’s location. Davies (2002) and Aguilera (2005) argue that ownership impacts the role of the board of directors. A distinction is made between three types of owners: institutional investors, families and individuals. Each owner has different requirements and concerns with regards to the board of directors (Thomsen & Pedersen, 2000; Anderson & Reeb, 2004). Institutional investor would prefer to maximise financial performance by electing outside board members (Sur et al., 2013) and be assured of a great efficiency and stability through specialisation, standardisation and routine of outside board members (Mintzberg, 1979). On the contrary, families and individuals are highly committed to the activities the company carries out making monitoring role of the board of director less important (Miller & Le Breton-Miller, 2005). As a result, families and individuals would prefer to appoint insiders to the board of directors such as other family members. Between the two extremes, Rumelt et al. (1991), Hillman & Dalziel (2003) and Sur et al. (2013) argue that management teams of funds that invest in other companies prefer a board of directors that focuses on human capital and may prefer a mix of outsiders and insiders on the board of directors resulting in higher board diversity.

Human capital is defined by Becker (1993) and Barroso et al. (2011) as a set of knowledge and skills which are typically developed through education, training and
experiences. For example, board members with an international education background are more likely to have an open-minded attitude towards other cultures. Barroso et al. (2011) find that board members’ managerial experience within the specific industry in which the portfolio company operates and a high level of academic achievement impact the international diversification of the company. Past studies consider that board members’ human capital influences the aptitude of board members to provide advice to portfolio companies (Certo, 2003). Similarly, Kor and Sundaramurthy (2009) report that board members and executives with a high degree of human capital are in a better position to provide high quality services. Kor and Sundaramurthy (2009) also report that only few studies provide empirical evidence on the effects of board members human capital on strategy and governance effectiveness. They consider that outside board members and managerial experiences have additive and interactive effects. They call future research to identify different types of board member’s human capital via empirical studies.

2.1.4. Board of directors’ factors of influence

Tasks carried out by the board of directors vary from a company to another and are specified in the articles of association (Corporate Governance Code, 2009). The most efficient way to perform these tasks is to bring together members’ expertise and experience to ensure an efficient decision making processes (Conger & Lawler, 2009). However, an efficient functioning of the board of directors is reduced due to limitations in information processing (Cyert & March, 1992) and the board of directors could miss information or cannot handle it properly (Ocasio, 1997). In addition, information that the board receives might be technical making interpretation difficult. Therefore, it is important that the board of directors gathers individuals with different fields of expertise (Conger & Lawler, 2009). Payne et al. (2009) show that knowledge, information, power and time positively affect board effectiveness. The first factor of influence refers to knowledge and is measured by expertise in strategy, finance or law. Knowledge improves decisions scope and quality made by the board of directors ensuring greater efficiency (Baysinger & Butler, 1985; Conger et al., 2001; Sonnenfeld, 2002; Hillman & Dalziel, 2003; O’Neal & Thomas, 1996). Second, information refers to data about actions that affect the business (Conger et al. 2001). The gathering of information reduces uncertainty and provides greater control over management (Hillman et al., 1999; Rutherford et al.,
The Influence of Venture Capitalists on their Portfolio Companies: Exploratory Case Studies from Belgium  

2007). Third, the relative power of the CEO has an impact on how decisions are accepted by the board of directors (Zajac & Westpha, 1996). A more proactive board of directors is observed when power mainly lies in the hands of board members which improves board efficiency (Pearce & Robinson, 1987; Pearce & Zahra, 1991; Payne et al., 2009). Fourth, time is necessary to make use of knowledge, information and power in an efficient manner (Conger et al., 2001). Greater board efficiency arises when more time is spent to a specific task (Pearce & Zahra, 1991; Payne et al., 2009). Barroso (2011) show the importance of human capital on board effectiveness. To conclude, we observe that past research shows that boards of directors’ are affected by both composition characteristics and factors of influence. We consider human capital to be crucial in gaining better comprehension of the relationship between venture capitalists and portfolio companies.

2.2. Shareholder activism

According to Gillan and Stark (2000) and Crane and Matten (2010), active investors use their rights as shareholders to make changes in portfolio companies to improve performance. Activist shareholders are engaged in active dialogue or confrontation when benefits of activism outweigh the costs (Pozen, 1994). This expensive activity is supported by large shareholders while other small shareholders benefit from it (Shleifer & Vishny, 1986; Huddart, 1993; Admati et al., 1994).

2.2.1. Motivation for activism

Prior research has focussed to a large extent on financial outcomes of activist actions (Bethel et al., 1998; Woidtke, 2002; Clifford, 2008) and to a lower extent on non-financial motivations of shareholder activism (Den Hond & De Bakker, 2007). Becht et al. (2009) and Klein and Zur (2009) found in a US context that investors are active in replacing board members, changing corporate strategy or opposing a merger. Shareholder activists may range from minority investors to large investors (Pozen, 1994).

Venture capital funds invest in businesses with high growth potential (Manigart & Witmeur, 2009). Venture capitalists pay attention to skills, quality and characteristics of the portfolio company management team and also to the market in which the firm
De Vlaminck, N. and Sarens, G. operates (Mason & Stark, 2004). Gorman and Sahlman (1989) and Sahlman (1990) first suggest that venture capital funds management teams provide capital and supplementary services resulting in the professionalization of their portfolio companies. Next to these seminal contributions, past studies identified mechanisms employed by venture capitalists to add value to portfolio companies. In particular, Bygrave and Timmons (1992), Hellmann and Puri (2002), Baker and Gompers (2003) and Cornelli and Yosha (2003) find that venture capitalists help firms to shape strategy, give technical guidance and provide commercial advice. Venture capitalists are determinant in monitoring management and help to reduce conflict of interests between shareholders and management as large stakes are often hold in portfolio companies (Shleifer & Vishny, 1986). Shareholder activism takes place most easily with large shareholders exercising pressure on management because they often have the possibility to interact more frequently with management (Loureiro, 2012). Sullivan and Kelly (2008) report that modern activism seeks to influence companies via the board of directors. Sullivan and Kelly (2008) suggest that attending board meeting and demonstrate responsiveness during board discussions is crucial for shareholder activists. In businesses backed with venture capital, the board of directors of is characterized by a small number of members and few insiders (Jensen, 1993). Finally, small board size and low insider representation are found to be related to higher involvement from venture capitalists (Judge & Zeithaml; 1992).

2.2.2. Targets of venture capitalists
The predisposition to conduct activist actions in portfolio companies depends on several company characteristics. First, Pozen (1994) shows in a US context that smaller firms are more likely to be targeted by shareholder activists than larger companies. Second, Pozen (1994) notes that poor firm performance is associated with activist actions. Del Guercio and Hawkins (1999) later find the same relationship between companies’ performance and activist actions. Third, we observe that concentrated ownership is negatively associated with shareholder activism because of higher ability to closely monitor management (Fama & Jensen, 1983; Gillan, 2000).

In addition to company characteristics, institutional context may influence associations of firm size, past performance and ownership concentration with shareholder activism.
Croci (2007) reports that UK activists are the most active in Europe. He argues that dispersed ownership might be a reason for such activism. La Porta et al. (1997) report that common law countries provide better protections for shareholder than civil law countries. Zattoni and Cuomo (2008) find that codes of corporate governance in common law countries codes are more likely to challenge managerial opportunism compared to civil law countries. Lastly, Djankov et al. (2008) report that managerial opportunism is more likely to be observed in common law than in civil law countries.

2.2.3. Venture capitalists activities
Past qualitative studies focus on venture capital management teams’ implication and include MacMillan et al. (1988), Rosenstein et al. (1993) and Sapienza et al. (1996). First, MacMillan et al. (1988) examine venture capitalists involvement in various post-investment activities. They find that serving as a sounding board to management was rated the highest. Then, Rosenstein et al. (1993) survey management of venture capital backed companies to assess the usefulness of venture capitalists activities. They report that serving as a sounding board was considered most valuable. The monitoring of operational performance and financial performance are evaluated as the third and fourth most valuable activities. Third, Sapienza et al. (1996) measure the importance and effectiveness of these activities from the perspective of both management and venture capitalist perspective. They find that the strategic role of venture capitalist was the most important and that serving as sounding board was rated as the most effective activity conducted by venture capitalists. In a case study by Martin (2000), it is shown that activism was required to rectify poor company governance and strategy.

3. Methodology and data
3.1. Methodology
Data collected are related to behaviours and opinions of board of directors’ members. We rely on Yin (2011) and Miles et al. (2014) to perform an objective analysis that allows drawing conclusions from subjective data. We also rely on methods used by Roberts et al. (2005) consisting of collecting experiences and opinions from various board members to
De Vlaminck, N. and Sarens, G.

shed light on actual board of directors behaviour and on how to create value. We consider that board members stories are particularly valuable to dig deeper into actual board behaviour.

We conducted semi-structured interviews in Belgium with a representative group composed of eight venture capitalists. Venture capital funds we surveyed are independents, related to a bank or to a university. Interviews took place in February and March 2014 and are based on a predetermined questionnaire consisting of 13 questions worded depending on the situation. Interviews lasted between 20 minutes and 45 minutes. This large difference is mainly due to the difference in interviewees’ characters, some interviewees gave brief answers while others went deeper into specific topics with examples. It was authorised to record the conversation at the beginning of each interview except for one case. Interviewees were invited to provide proofreading and remarks. We decided to keep anonymous venture capitalists names and affiliations.

3.2. Data

The first venture capitalist we interviewed (case 1) is related to a Belgian university and invests in spin-offs of the university at seed stage* taking both minority and majority stakes. The interviewee is managing director of the fund and serves on several boards of directors. The second venture capitalist (case 2) focuses on growth capital† and buyouts‡. An important feature of the fund is that at least a majority of the shares are bought in each portfolio company. The interviewee belongs to the fund management team and has several years of experience on boards of directors. The third venture capitalist (case 3) is a listed investment company that invests in innovative start-ups and growth companies. The interviewee is responsible for venture capital investment and has experienced boards of directors for many years. The fourth venture capitalist (case 4) is an internationally oriented venture capital fund that invests in several countries at both seed and growth stages. The fund only holds minority stakes and always requires a seat on the board of directors. The fifth venture capitalist (case 5) works as a specialist in private equity and

* Seed investments are relatively small amounts of capital provided to businesses to finance the early development of a new product or service.
† Growth capital is provided to facilitate companies to accelerate growth and to start operations.
‡ Buyout capital refers to later stage investments and involves more mature companies that generate significant cash flow.
venture capital for a large bank. The fund has minority interests and owns participations in Belgian start-ups at both growth stage and buyout level. The interviewee is investment director and chairman of a number of young Belgian companies. The sixth venture capital fund (case 6) is related to a Belgian family and holds minority participations. Fund representatives always demand a seat on the board of directors. The seventh venture capitalist (case 7) manages two funds. One fund is devoted to seed capital while the other focuses on growth financing. The two funds work together and share the same vision. The funds always own minority stakes and is not always represented on the board of directors. The interviewee is a partner of the investment company and is member of several boards of directors. The eighth venture capitalist (case 8) focusses on growth and buyout investments. Both minority and majority stakes are hold and a seat on the board of directors is a necessary condition to provide funds to a company. The interviewee has been working for two years as a partner of the fund and sits on several boards of directors.

Data analysis started with the transcripts of the interviews and formed the basis for further analysis. Transcripts were coded via the method employed by Miles and Huberman (1984) and Miles et al. (2014). For each interview, data were assigned to different topics (codes) and compared between cases so that we are able to observe similarities and differences among cases.

4. Empirical results
Empirical results are presented in four sections: venture capital activism, venture capitalists on the board of directors, venture capitalists outside the board of directors and influence of non-board members. We observe that both formal and informal channels are employed to exert influence on board decision making process.

4.1. Venture capital activism
Two categories of investors are identified by interviewees. On the one hand, shareholders may choose to be confined to official channels and interact with a portfolio company via
the general assembly. On the other hand, investors may be part of the board of directors and participate in the board decision making process. Each interviewee considers being part of the second category and describing themselves as active shareholders. A definition of active shareholder is given in case 7: “It is not the intention to invest our money and wait and see what happens to it five or ten years later. We try to help as much as possible but as we see that our help is not appreciated, we go a bit down to the back seat. My experience is that if a company does well, you’re there to do very little work. In difficult cases, you spend a lot of time.” [Partner – case 7] However, each interviewee has her or his own definition of shareholder activism. An active shareholder is generally described as a person willing to help the company through the board of directors or via other mechanisms. Case 4 representative reports that: “We’re trying to give all day management a certain added-value.” [Venture Partner – case 4] Nevertheless, we notice some important nuances. Companies that are doing well and have followed their business plan in time have a smaller need for activist actions. “Basically, you invest a lot of time in the follow-up of a company especially when things go wrong. If everything goes well, then we are not going to interfere that much.” [Principal – case 3] This is coherent with Ocasio (1997) and Hillman et al. (2008) that suggest that investors’ implication in not constant but changes through time. In cases 1 and 6, an active participation depends on the size of the participation. A large stake means more implication which is consistent with Huddart (1993) and Admati et al. (1994) that suggest that shareholders conduct activist actions when the costs benefits balance is more favourable. We report from cases 3, 4, 7 and 8 that activism is related to portfolio companies’ performance. We observe that a less active approach is adopted when a company achieves good results. So, the degree of activism depends from company to company and is similar to the findings of Pozen (1994) and Del Guercio and Hawkins (1999) that report an association between past firm performance and activist actions. Finally, we observe in case 2 that a number of ad hoc management tasks are performed by venture capital fund management team. More involvement in daily management tasks shows that this fund operates in duo with management of its portfolio companies. On the contrary, cases 1 and 5 report explicitly an absence of involvement in daily management operations as they perceive that these tasks belong to management. Between the two extremes, other interviewees suggest that involvement in daily operations occurs only exceptionally. This might happen for a
specific project and only for a limited period of time. When a start-up is trapped in a difficult phase, venture capital fund management teams try to bring support.

4.2. Venture capitalists on the board of directors

Prior to any investment, venture capitalists ensure that management shares long term shareholders’ vision. In case 6, we note that: “We will never ask anything to the CEO which is not in line with the board” [Investment Director – case 6] Each interviewee reports that the exit is addressed with management at the beginning of the relationship except in case 2. The reason to talk about exit at the beginning is that an interest alignment is sought by venture capitalists at the beginning of the relationship to prevent future conflicts. This is not observed in case 2 because investments last over a longer term horizon.

A key question in the study is whether the board of directors is considered as the primary governance device to interact with portfolio companies. We confirm the centrality of the board of directors and report, for example, from case 8 that: “working directly through the board of directors is optimal for both minority and majority shareholders.” [Investment Partner – case 8] We report from case 5 that having a seat on the board and the board of directors is a bare necessity. This is in line with Sapienza (1992), Lerner (1995) and Busenitz et al. (2004) that consider the board of directors to be the main governance mechanism. We observe in cases 3 and 6 formalisation and professionalization of boards of directors. Cases 3, 6, 7 and 8 emphasise that the primary focus is on strategy and on growing the company in the long run.

The business plan plays an important role in the relationship between management and shareholders. In each case, venture capital funds management teams are involved in decisions related to strategy and strategy implementation. In case 1, we see that discussions are about strategic decisions and are down to earth. We note that: “The board of directors is a place to open discussion between all members. We say what we think and try to convince others.” [Investment Director – case 6] Interviewees report that in theory decisions are made through voting but in practice votes rarely happen. Members of the
board of directors are keen to reach a consensus even if venture capitalists have veto rights or demand special majorities on specific decisions. According to the case 4 representative, it is important to achieve a consensus whenever possible. “You always try reaching a consensus in the board” [Venture Partner – case 4] We notice that veto rights are important in case of blockage in the discussion. However, we remark that the board is usually unanimous in making decisions. In case 2, we find that veto rights and special majorities are used as little as possible. The effective functioning of the board of directors is described by the interviewees as a striving for consensus. Only in exceptional circumstances the board of directors proceed to a vote. Case 2 representative declares: “I must say that I do not believe in voting on a board of directors. I believe much more in knowledge as a mean to bring back together positions on a specific topic.” [Managing Director – case 2] Case 4, 7 and 8 believe it is the management responsibility to identify problems and provide few solutions. The role of the board is to determine the best solution.

We find several ways used by venture capitalists to influence the board decision making process. First, we observed that all venture capital funds make use of their skills on the board of directors depending on company needs. They also share experience, expertise and network connections. “As a board member, sometimes you will be more active on certain topics according to your own experience. On other topics, you will be more like a follower because you feel that experience is on the other side. Your weigh depends on what topic is discussed.” [Managing Director – case 2] For example, case 1 provides contacts with new investors or large corporations’ executives and case 6 venture capital funds provide best practices to portfolio companies. Based on their experience in growing companies, they know how certain things are better implemented and provide support to portfolio companies. Venture capitalist representative of case 2 believes that experience and knowledge are useful to exert influence on decisions made by the board of directors. This is in line with Forbes and Milliken (1999), Zona & Zattoni (2007) and Kor and Sundaramurthy (2009) that show that human capital affects positively boards of directors’ effectiveness. The board of directors is more attentive if a board member has the right expertise and knows how to deliver added-value. We report from case 6 that: “If another shareholder has the same vision that we have, then this is going to help as a
The Influence of Venture Capitalists on their Portfolio Companies: Exploratory Case Studies from Belgium

Second, case 3 impacts board decision making process in another way: the fund provides a 180 days plan that describes good and bad points of the company. This plan is subsequently discussed during the next board meeting. Third, we observe in case 6 that the agenda of the board of directors is a manner to impact board discussions. In cases 6 and 8, the setting of the agenda can exert a certain influence on board discussions. “Our role is to express an opinion on elements of the agenda in the best interest of the company. As board member, it is your responsibility to have information to express a good opinion.” [Investment Director – case 5] Fourth, preparation of topics is a manner to impact decisions made by the board of directors. Fifth, we find in case 7 the shareholders’ agreement is an important tool to intervene if management does not act as agreed. For example, venture capitalists might influence more easily the decision to exit if an exit period is included in the shareholder agreement. Lastly, we observe that much of influence depends on persuasiveness, reputation and previous experience of board members to guide the discussion. This reinforces human capital as key in assessing board member’s influence on boards of directors and is consistent with prior literature (Gimeno et al., 1997; Pennings et al., 1998; Bertrand & Schoar, 2003; Beckman et al., 2007; Zarutskie et al., 2010).

Then, we find that venture capitalists express their opinion on the hiring of key personnel, new investments, issuance of new loans, capital increases, capital reductions, bonuses, expansion of operations, sales of assets, acquisitions and amendments to the shareholders’ agreement. Our findings are consistent with prior studies that report an implication in portfolio companies management teams (Mason & Stark, 2004) and on strategy (Bygrave & Timmons; 1992, Hellmann & Puri; 2002, Baker & Gompers; 2003, Cornelli & Yoshia, 2003). The better the company does, the less time venture capitalists devote to the follow-up of their portfolio companies. Finally, we report from case 8 that venture capital fund management team is willing to be a sounding board to the management which is consistent with MacMillan et al. (1988) and Rosenstein et al. (1993).
The monitoring role of the board of directors is mentioned by interviewees and is related to the compliance role of the board. In case 2, reporting is considered as an important board duty. The venture capital management team determines how frequent reporting should be done and what it should contain. In case 4, venture capitalist takes care of monitoring management by looking at how much money per year is spent by the company and to what purpose. These findings are in line with past studies (Zahra & Pearce, 1989; Johnson et al, 1996; Stiles & Taylor, 2001).

Finally, the entrance of new investors is positively perceived by venture capitalists in cases 3 and 6 since portfolio companies are likely to grow more rapidly and more experience and expertise is made available to portfolio companies. In cases 1, 4 and 7, however, entrance of new investors is negatively perceived as it may lower influence of current investors on the board of directors. In case 8, effects of new investors depend mainly on the autonomy of portfolio companies’ management teams and on venture capitalists’ involvement in the strategy of portfolio firms.

4.3. Venture capitalists outside the board of directors

In addition to the board of directors, we observe that venture capital funds management teams that have a seat on the board of directors as well as those who do not have a seat exert influence on portfolio companies’ decisions outside the board of directors. In cases 3 and 7, we report that strategic committees might be created besides the board of directors and includes board members plus non-board members to discuss strategic orientations. In addition, frequent contacts take place with management and contribute to have an influence on company’s decisions. In case 2, we remark that the venture capitalist is eager to keep an exclusive relationship with management of portfolio companies. All interviewees report that efforts are made to be listened by management and therefore impact decisions. Frequent contacts ensure venture capital funds to obtain more information about the business and to be in position to share ideas and comments more easily. All interviewees make clear to management that their support is available.

“Working with the CEO and help him when he has problems is the best influence you can exert. This is the best way, it's give and take. You give some of your time, knowledge and network and in return you get respect from the CEO who's listening to you” [Venture
Partner – case 4] In case 7, we also observe that the venture capitalist shows to portfolio companies’ executives that they can rely on their support without any doubt. Influence of the board of directors may not be in absolute terms: "A director cannot make decisions on his own, you have to involve company’s management." [General Director – case 1] In case 3, we notice that venture capitalist attempts to build an intense relationship with management and assure management of support outside the board of directors. We report that venture capitalists consider that management should not wait for the formal board of directors to speak of business issues given that the environment in which portfolio companies operate evolves rapidly. As a result, venture capital funds perceive themselves as mentors or right hands of CEOs. In case 2, we report a very strong relationship with management where the business is run in duo with portfolio companies’ management teams. Similarly, we observe in case 4 that operational activities might sometimes be performed to relieve management of certain tasks. This shows that interviewees do not only work on the board of directors but have frequent contacts with management. Our findings are consistent with Loureiro (2012) that expresses that frequent contacts with management take place in presence of active shareholders.

4.4. Influence of non-board members

We find that venture capital fund management teams that are not represented on the board of directors seek to obtain the same information as board members. In case 1, we note that: “In some cases, I think that we are not sufficiently informed. We may be a small shareholder but I think we have a right to get access to information” [General Director – case 1] We also notice an attempt to influence board decision making process in most cases and questions might be asked during the general assembly. However, case 2 representative believes that actions via the general assembly are not ideal because discussions mostly deal with past decisions. We remark that an observer position might be demanded by venture capital funds management teams when not represented on the board of directors. That position allows to obtain the same information as board members and to share an opinion without voting rights. More informally, the fund may interact with the board members via phone calls or e-mails. In case 7, we notice frequent contacts with the board of directors which allows making suggestions and provides information
about board’s discussions. We note that: “It is the role of the board of directors to make contact with all shareholders.” [Partner – case 7] Through intense contacts with the board of directors a venture capitalist representative possesses as much information as a fund that is represented on the board of directors. “It's a small world and we know each other very well, we know what the others want. We’re always open to suggestions.” [Principal – case 3] However, ideas that small shareholders provide to the board of directors are not all taken into account otherwise the decision making process tends to be ineffective. Cases 3 and 6 emphasize that only important suggestions are discussed on the board of directors. This is consistent with the vision of case 2 representative that suggests that small shareholders propositions are not always discussed on the board of directors. “You cannot ask all shareholders to say what they think, otherwise it is completely unworkable. You should be able to keep it for you.” [General Director – case 1] This shows that small shareholders can exert influence on the board of directors but this influence is limited. As a result, it is clear that informal ways are as important as formal governance mechanisms to exert an impact on portfolio companies and to have an access to information.

5. Conclusions

The study started by presenting past literature on boards of directors and shareholder activism. It became apparent that venture capital funds generally undertake an active role in their portfolio companies via the board of directors as main corporate governance device (Sapienza, 1992; Lerner, 1995; Busenitz et al., 2004). The focus on small and growing businesses backed with venture capital in the context of Belgium differs from prior studies that mainly concentrated on Anglo-Saxon countries and on large companies. Venture capital funding is characterized by a long time horizon which reinforces relationships between management teams and board members, especially when ownership is stable. We emphasised the importance of human capital to gain better understanding of the actual work of boards of directors.

Interviewees describe themselves as active shareholders providing support to portfolio companies when needed. First, we find that the board of directors is considered as a device to act on strategy and strategy implementation. We notice that influence is limited
when venture capital funds management teams do not sit on the board of directors. Our results show that venture capitalists are active in dismissing and recruiting managers, help with fundraising, facilitate contacts with other companies’ executives, contribute to the development of new activities and are involved in the selling of companies’ assets. These decisions are mainly influenced by the work carried out by the board of directors.

We observe a difference between the influence of board members and non-board members on the board of directors. Six out of the eight interviewees are always represented on the board of directors of portfolio companies. When not on the board of directors because of low levels of shares owned, we report that venture capitalist influence is affected. We confirm previous findings by Bygrave and Timmons (1992), Sapienza et al. (1996), Hellmann and Puri (2002), Baker and Gompers (2003) and Cornelli and Yoshia (2003) that find that venture capitalists help portfolio companies shape strategy, provide technical guidance and give commercial advice. We also report that the board of directors is composed of a limited number of members and include both insiders and outsiders which are in line with Judge and Zeithaml (1992) and Sur et al. (2013). Our results are also in line with the findings of Sullivan and Kelly (2008) that report that activism is exerted via the board of directors. Therefore, the study confirms the centrality of the board of directors in the governance of portfolio companies backed with venture capital.

Further, we notice that board members impact the decision making process via both formal and informal channels. On the one hand, formal ways consist in working through veto rights, ordinary majorities and special majorities. Nevertheless, little utilisation of formal tools is observed in practice since consensual decisions are reached most of the time. To vote and the use of the veto rights or majorities are rather an exception. The general assembly is a governance device that might be employed by non-board members but its impact on the decision making process is found to be limited. On the other hand, informal ways are employed to weight on board decision making process and include the use of knowledge, experience and network of venture capital fund management teams which is in line with Forbes and Milliken (1999) and Zona and Zattoni (2007). The right use of these informal mechanisms of influence allows board members to impact
decisions. Veto rights, ordinary majorities and special majorities are important but human capital like knowledge, experience and network are the most important tools to convince other board members and influence decisions. In addition, agenda preparation is a way to arrange topics to be discussed at board meetings. Moreover, venture capital management teams prepare topics to be discussed in advance. In this way additional information may be gathered and relevant arguments may be expressed in line with their views. We report that an observer position is most of time required when no seat on the board of directors is obtained. This gives support to the board of directors as key governance mechanism for young and growing companies backed with venture capital. We report informal contacts between venture capitalists and management. All interviewees report that they try to build an intense relationship with management to share opinions and indirectly exert an influence on the board decision making process. We also report frequent contact between venture capitalists that have a seat on the board of directors and those who do not. We observe that board members’ personality and fund management teams experience are crucial. Finally, we find that the entrance of new investors has a mixed impact on the influence of venture capitalists.

To conclude, we report an ambiguous configuration with the coexistence of boards of directors imposed by the corporate code and law and frequent informal contacts between board members and management. We cast doubt on the added-value provided by boards of directors in the context of companies backed with venture capital that evolve in a rapidly changing environment. We suspect that the bio-rhythm of venture capital backed companies may not be in accordance with a rigid governance device such as the board of directors. As a result, informal contacts regularly appear to adapt to the needs of portfolio companies. We wonder whether the role of the board of directors could be considered as a steering committee or a think-tank to shape company’s strategy. We also wonder if control processes may be hidden in informal contacts between venture capitalists and portfolio companies’ management teams given that the environment in which portfolio companies operate is uncertain and evolves rapidly.

6. Future research
We are prudent in generalising our findings. Indeed, institutional context plays a role in the relation that venture capital funds management teams have with their portfolio companies and on venture capital activism. Further research might therefore dig deeper into Belgium or focus on neighbouring countries. Future studies may also draw attention on the influence of investors of later stage companies since we intentionally chose to study young and growing businesses back with venture capital. Second, we incite researchers to conduct paired interviews with both venture capitalists and entrepreneurs to gain greater knowledge of the influence of venture capitalists on their portfolio companies. It is possible that management perceives differently the influence of venture capitalists. We join up with Huse (2005) that suggests board members affiliation may result in various perceptions of the actual board behaviour. Further, scholars may investigate whether various perceptions and diversity among board members impact governance effectiveness. We believe that the relationship between human capital and governance effectiveness is still an avenue for future research.

Finally, we report a lack of theoretical framework that corresponds to the context of the study. We observe that corporate governance literature is dominated by an Anglo-Saxon research model that focuses on protecting investors’ interests. We are in accordance with Roberts et al. (2005) that report that academic research needs to go beyond agency conceptions of boards’ functioning. Past research on boards of directors is fragmented and used various theories without providing an integrated framework (Huse, 2005). The qualitative approach of the study allowed exploring limitations of agency assumptions. We believe that complementary theoretical approaches may contribute to a better comprehension of board of directors functioning in contexts where agency assumptions are relaxed. As a result, we challenge the dominance of agency theory on governance research and encourage the search for multi-theoretical approaches.

References


De Vlaninck, N. and Sarens, G.


