TALENT CAPITAL:
MAXIMISING YOUR GREATEST ASSET

FOR VC AND CVC INVESTORS

INTRAMEZZO
executive talent solutions

FOREWORD

High-growth SMEs play a vital role – they create jobs, drive the economy and increase competition in their markets, leading to better outcomes for customers.

A recent Octopus Investments and Centre for Economics and Business Research report* found that in 2013, high-growth, small businesses accounted for just 3.4% of the UK economy, but were responsible for 32.6% of the UK's economic growth. They also accounted for 68% of employment growth between 2012 and 2013.

Yet they also face a significant challenge: finding the right talent to bring into their leadership teams. The Octopus research suggested that over one in five felt this was holding back their growth. It's a theme also picked up by leading entrepreneur and angel investor, Sherry Coutu, CBE, in her report** on scale-up businesses: the top challenges facing these companies were, in first place, finding employees with the right skills and, second, building leadership capability.

With the weight of evidence showing that building out high-quality leadership teams is a serious issue for early-stage, fast-growth businesses, we wanted to drill down into the key talent issues facing the investment community today, analyse existing approaches and uncover the science behind structuring a world-class leadership team.

The responses to our survey of over 100 corporate venture capital and venture capital fund managers demonstrate that investors' portfolio companies are vying for a finite supply of high-calibre executives. The individuals they seek clearly need an entrepreneurial mindset. As our survey shows, this is challenging enough, but what they really need are those rare people who can lead a business through hypergrowth and build the global businesses of tomorrow.

And while investors are recognising that a planned approach to evaluating, acquiring, developing and retaining board and C-level talent in their portfolio companies is central to driving business value, not all appointments are successful. This often results in serious consequences, such as significant lost growth and momentum, management distraction, high employee turnover and delayed exit.

If the mistakes of the past are to be avoided, talent capital must be given equal billing to investment capital. Vital funding and support from investors, together with high-quality leadership teams, offer young, innovative companies a winning combination and the potential to become world-leading businesses.

G. Worden

Georgina Worden
Director, Intramezzo Ltd.

ACKNOWLEDGEMENTS
We are grateful to the many globally recognised brands and leading venture capital (VC) firms internationally who have contributed to this survey.

Our particular thanks go to CBPE, DFJ Esprit, Finance Yorkshire, KLM's Mainport Innovations Fund, MS Ventures, Octopus Ventures, Stonehage FF&P and Transamerica Ventures for sharing their additional, valued insights.

We are delighted to have worked with the Global Corporate Venturing team as our survey partners and greatly appreciate their considerable contribution.

The BVCA and Beauhurst were also involved in circulating details of this survey, for which we offer many thanks.

* Octopus High Growth Small Business Report, 2014 ** The Scale-up Report on UK Economic Growth, 2014

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EXECUTIVE SUMMARY

- **Leadership drives the decision to invest.** Nearly 90% of VC and corporate venture capital (CVC) respondents ranked the quality and strength of the leadership team as a top three factor in their decision to invest in portfolio companies and 85% said they were unlikely or highly unlikely to back a company that lacked the right skills.

- **Senior talent added post-investment.** Most investors do not expect management teams to be complete in early-stage businesses and anticipate the need to strengthen the board during or after investment. Nearly half (48%) always or frequently appoint sales directors, with CFOs, non-executive positions and chairmen also frequently recruited by investors.

- **VCs replace or appoint at a board level more frequently than CVCs**, suggesting a more proactive approach to talent management in portfolio companies. Half of VCs always or frequently replace CFOs (versus 14% of CVCs), 41% appoint non-executive directors (against 10.5% of CVCs) and 32.5% frequently appoint a new chairman (13.2% of CVCs do this).

- **CEOs are changed surprisingly frequently**. Over a quarter of respondents always or frequently replace CEOs during the course of an investment. This is largely down to the fast growth of many portfolio companies – the business often outgrows the individual's skill sets, leaving him or her to take another role, commonly CTO.

- **Finding talent is the biggest barrier to growth in portfolio companies**. This was cited as a major or moderate barrier by 81% of respondents, followed by customer demand and a competitive marketplace. The biggest challenge associated with sourcing talent is finding people with entrepreneurial experience and mindset, followed by cultural fit.

- **Sourcing candidates with the right skills and experience is the biggest challenge when making senior hires**. Nearly 90% of respondents ranked this as a major or moderate challenge, followed by making an appointment quickly enough (67%). Nearly two-thirds (60%) said that identifying skills gaps is a major or moderate challenge, highlighting the need for a more systematic and strategic approach to senior level talent management.

- **Networks are the most successful means of sourcing senior candidates, but executive search is important**. Over half (55%) said using networks is the most effective way of making executive appointments, while 43% cited executive search as the most successful route. Advertising and general recruitment firms received no mentions by respondents.

- **Failed senior appointments lead to substantial loss of growth and opportunity**. Over 90% of respondents had experience of a failed appointment, with very serious consequences: 46% said the lost annual growth potential for the portfolio company was between 10% and 30%, and 20% said it was even higher – between 30% and 60%. In the majority of cases, the wrong senior level appointment causes portfolio businesses to fail to achieve their business plan, miss commercial milestones and for management distraction to lead to missed opportunities. In some cases, the damage is irreparable.

90% Over 90% of respondents had experience of a failed appointment.

TOP TALENT IS KEY IN THE DECISION TO INVEST

The decision on whether to invest in a business is clearly based on a complex interplay of many different factors, particularly in earlier-stage companies that may not yet have a proven business model or have reached the stage of profit or revenue generation. Prospective investors must therefore consider areas such as the scale of a product's potential market and the extent of innovation or disruption the product or service might bring to the market.

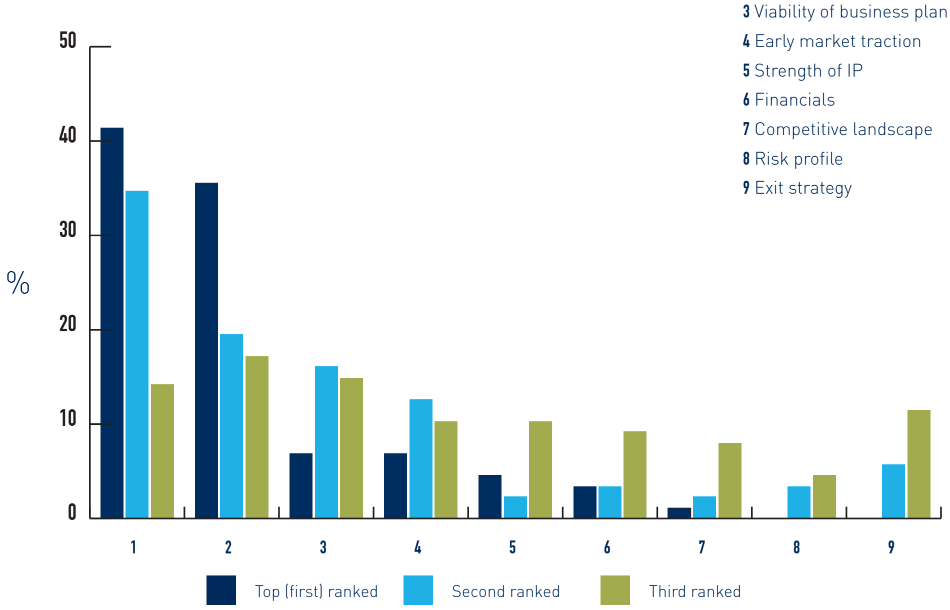
This variety of factors was reflected in our survey, with commercial potential of the company's product, viability of the business plan and early market traction all ranking highly as areas for consideration by CVCs and VCs considering an investment (see Figure 1). Understandably, given their strategic aims for making investments, CVCs tended to rank strength of IP more highly than VCs, with 20% putting this in the top three considerations (vs 10% for VCs). The VCs' stronger emphasis on financial returns also came through, with 25% ranking the company's financials in the top three (vs 10% for CVCs).

FIGURE 1

WHEN CONSIDERING AN INVESTMENT, WHAT ARE THE THREE MOST IMPORTANT FACTORS IN YOUR DECISION MAKING?

KEY

1 Leadership team
2 Commercial potential
3 Viability of business plan
4 Early market traction
5 Strength of IP
6 Financials
7 Competitive landscape
8 Risk profile
9 Exit strategy



WHAT MAKES A TOP TEAM?

The focus of investors' attention is naturally on the CEO, the lynchpin of the leadership team. Many respondents felt that, if there were gaps in the top team, other senior level appointments could be made post-investment – as long as they had the right CEO on board.

Backable CEOs need the right interpersonal qualities. "The CEOs in corporate-backed ventures – at the outset at least – will often be running small teams and so they really have to be effective leaders. They need the ability to find, hire and motivate good people," says Paul Morris, Director, Corporate Venture Capital at UKTI.

"We look for a leader who really is a leader. They need to be decisive while at the same time be able to take into consideration the views of people around them. They also need that rare magnetic quality that inspires people to be part of their journey."

George Whitehead,
Venture Partner Manager at Octopus Ventures

However, this also needs to be supported by a strong vision and demonstrated ability to deliver on this. "We need to be sure that the management team, led by the CEO, can execute on their stated strategy," says Egbert Bierman, Investment Director at Transamerica Ventures, the corporate venturing arm of Aegon. "We want to see that the CEO has the potential to be a leader of a £100m business, not just a £1m business."

While in most cases, investors focus on CEOs, the CTO role was also important, particularly for CVCs. Often, these individuals are co-founders of the business and their role is seen as pivotal to the success of the potential investment, given the innovative and/or disruptive nature of the technologies CVCs are seeking access to. "The product person, or CTO, is vital," says Bierman. "We want to see that they can deliver on time and in the right way."

"In early-stage businesses, the CTO is critical in leading technology development," says Morris. "As a start-up evolves, the board may recognise that a new CEO is needed to take the company to the next stage. Where the incumbent is the technical founder, he or she may be more effective in the role of CTO."

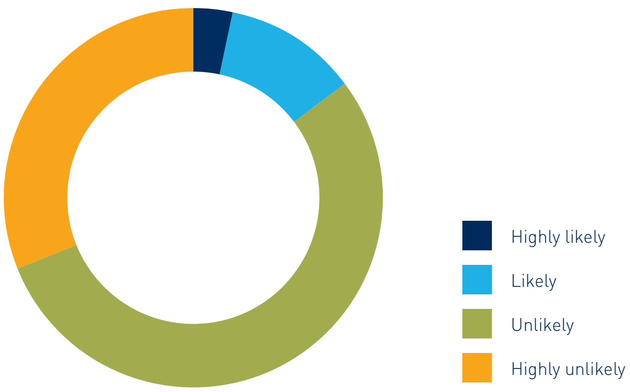
Yet the most important factor of all – perhaps unsurprisingly – was the strength and quality of the company's leadership team. Nearly 90% of respondents cited this as a top three factor with half of these saying this was the top consideration in an investment.

"The leadership team is the single most important factor for us," says Richard Hill, who is responsible for direct investments at Stonehage FF&P. "We want to see that members can work individually and as a team and that they can demonstrate past success. If you are investing in an early-stage company, you don't have much to go on other than the team and its product or service."

This finding was endorsed by the fact that 85% of respondents said they were unlikely or highly unlikely to invest in a company if they felt that the existing leadership team lacked the skills or experience to realise the company's growth plans (see Figure 2). This does not mean that the team must be complete, as we explore on page 11.

FIGURE 2

HOW LIKELY IS IT THAT YOU WOULD COMMIT TO AN INVESTMENT IF YOU FELT THE EXISTING LEADERSHIP TEAM LACKED THE SKILLS/EXPERTISE TO REALISE THE COMPANY'S GROWTH PLANS?



90%

Nearly 90% of respondents said that the strength of the leadership team was one of the three most important factors when making an investment.

HOW ARE TEAMS ASSESSED?

CVCs and VCs assess the quality of senior teams in a variety of ways, from spending time in both formal meetings and more informal settings to taking references from former colleagues and employees and/or employers. As Roel Bulthuis, Managing Director of MS Ventures, comments: "We make a point of never investing in a business unless we've spent at least two evenings with the team over a meal and a glass of wine – we have to look at the team in a personal light."

However, there are signs that the process around talent assessment is becoming more structured, particularly among VCs.

"There is a lot of gut feel in this – and that only comes with experience," says Andrew Nelson, Director, CBPE. "However, we are doing a lot more validation work on management teams nowadays and we have become more sophisticated in the way we assess teams. For example, we recently used an organisation to do formal referencing for us, which included time spent with individual team members as well as in group settings. This exercise plays an important part in rounding out our previously formed view."

George Whitehead, Venture Partner Manager, Octopus Ventures, adds: "We compile a report on management before we invest. This outlines the strengths of the team, but also identifies any gaps – at times this can be quite personal, but the reaction is usually positive because the people we are looking to back want to ensure they are doing all they can to grow the business."

Where this type of due diligence work is carried out by VCs it is highly valued by CVCs who co-invest alongside them.

"We do background research on individuals and teams, but as we co-invest with others, particularly VCs, we also often rely on the information they can gather and leverage their experience of backing teams," said a corporate venturing respondent.

POINTS FOR TEAMS LOOKING FOR INVESTMENT

1 Given investors' focus on this role specifically, make sure the CEO is highly backable.

This means he or she is a good leader that can carry the rest of the team with him or her, can articulate the company's vision succinctly and with conviction, understands the market inside out, is outward focusing and spends a lot of time with customers (potential or existing), and is open to constructive feedback.

2 Work out potential skills gaps in advance of seeking investment.

While investors will do their own due diligence and checks, demonstrating an awareness of the team's current strengths and weaknesses as well as a plan for what might be needed in future is a good signal to investors that the management team is managing talent effectively. This process can also help identify whether some of the funding raised should go towards strengthening the team.

3 Understand the differing objectives of investors.

VC investors are seeking financial returns; CVCs, while they may provide a new and ready market for your technology as well as personnel and R&D support, do have more strategic objectives. As Paul Morris of UKTI says: "Ask yourself why a $60bn corporate would put money into a $2m investment – the financial return wouldn't move the needle so you need to be comfortable with the strategic aims of the investor."

THE NEED TO REPLACE OR APPOINT TALENT

The fact that earlier-stage businesses are just that – newly formed ventures in need of shaping and nurturing to help them grow – is reflected in our survey. As discussed, and as evidenced by the processes undertaken to assess skills and experience before investing, many prospective investors are not expecting complete management teams at the point of committing capital. They anticipate the need to bring in new senior-level talent during the course of the investment.

"As we grow the company – often from seed stage or even earlier as we may sometimes build a business from a scientific paper – we'll add new roles. One of the areas we can really add value to these companies is helping to build teams at an executive level."

Roel Bulthuis,
Managing Director of MS Ventures

We set out to discover which senior roles are most frequently appointed or replaced post-investment. CVCs and VCs both appointed or replaced sales directors most frequently, with nearly half (48%) saying they always or frequently did this (see Figure 3). For some businesses, this may be a newly created role to complement the efforts of a CEO who will have spent time establishing a market for the company's product or services; in others, it may be that the incumbent sales director does not have the capacity to grow with the business. CFOs, non-executive directors, chairmen and (perhaps surprisingly, given investors' focus on this role) CEOs were also mentioned as being relatively frequently appointed or replaced.

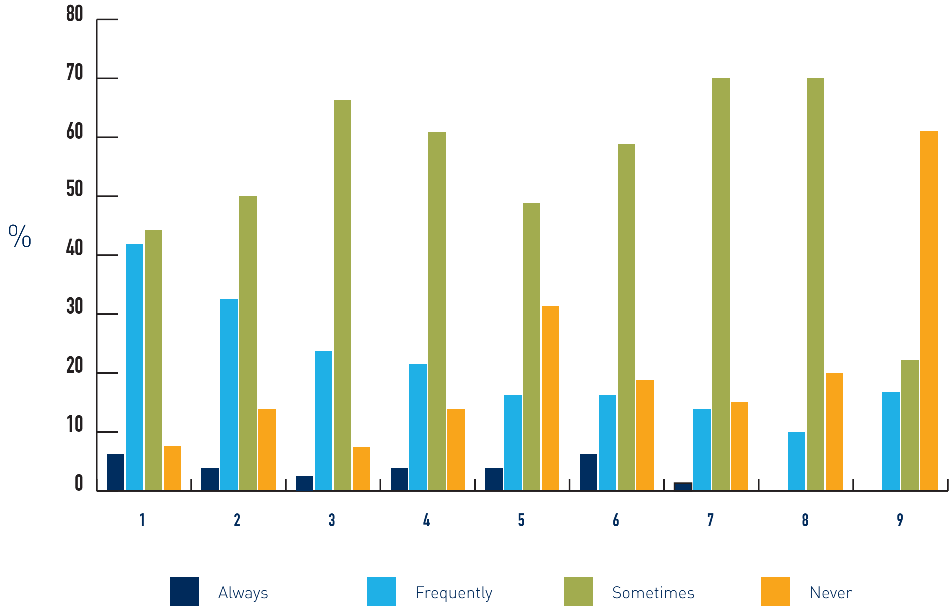
48%
of respondents always or frequently replace sales directors.

FIGURE 3

HOW FREQUENTLY DO YOU NEED TO APPOINT/REPLACE THE FOLLOWING POSITIONS IN YOUR PORTFOLIO BUSINESSES?

KEY

1 Sales Director
2 CFO
3 CEO
4 Non-Executive Director
5 Interim
6 Chairman
7 COO
8 CTO
9 Other



VCs APPOINT MORE REGULARLY; CVCs TAKE A DIFFERENT TACK

However, there is an important distinction between the results from the two types of respondent: VCs are far more likely to appoint or replace senior-level talent. While the responses between the two groups for sales directors were broadly similar, those for other roles were markedly different (see Figure 4).

Half of VCs either always or frequently appoint a new CFO during the course of the investment (compared with just 24% of CVCs), 41% of VCs often appoint new non-executive directors (versus 10.5% of CVCs), and 32.5% frequently or always appoint a new chairman or CEO of the business (against 13.2% and 21%, respectively, among CVCs).

This may, in part, suggest that VCs are more proactive in their approach to bringing in new talent or replacing underperforming team members than CVCs, reflecting their focus on achieving financial results within a given time period in order to achieve exit. The fact that new CFOs are frequently recruited in VC-backed companies bears testament to this, as well as the emphasis this type of investor places on performance measurement and reporting.

Chairmen and non-executive directors are often brought in by VCs to supplement the skills, experience and knowledge of the existing team as a matter of course. As Paul Gower, Investment Director at Finance Yorkshire, comments: "Many of the teams we back don't have the experience of fast growth or going into new markets, so we tend to view the value of new non-executive directors not just in the work they do, but in the experience they bring. They have made – and learned from – mistakes, can spot potential problems and can provide insight into how to avoid them."

Yet this does not mean that CVCs ignore the issue of bringing in new talent in portfolio companies; many simply take a

FIGURE 4

HOW FREQUENTLY DO YOU NEED TO APPOINT/REPLACE THE FOLLOWING POSITIONS IN YOUR PORTFOLIO BUSINESSES? CVCs v VCs

KEY

1 Sales Director
2 CEO
3 CFO
4 Interim
5 Chairman
6 Non-Executive Director
7 CTO
8 COO
9 Other

different approach. Instead of making new hires, some bring to bear the skills of their internal resources. "There are a number of corporates that use their venture activities as a talent management pool," says Egbert Bierman, Investment Director at Transamerica Ventures. "They recognise that they have talented managers sitting within the corporate environment and they put these people beyond their comfort zone next to the CEO of a portfolio company. This is a really effective way of bringing knowledge and experience at a senior level to a young company, while also keeping existing staff motivated."

"We tend to bring in people from the parent in a consultancy-type role," says Bulthuis. "It allows our portfolio companies to borrow specific expertise. We wouldn't use talent from the parent in an executive capacity, largely because they wouldn't have the same incentives as the management team or have the right experience."

"In 95% of cases, we bring new non-executive chairmen into portfolio companies. It is good to have a fresh start and set the tone for the investment. This needs to be someone who is truly independent of the management team and of us as an investor so he or she can play an 'honest broker' role."

Andrew Nelson,
Director at CBPE

COMPANY GROWTH TRIGGERS NEW APPOINTMENTS

With so much focus among investors on the quality of the leadership team – and particularly of the CEO – before an investment is made, the finding that new people are appointed to these roles relatively frequently is perhaps surprising.

When we asked respondents what tended to trigger new appointments, the most frequent reason was the company's entry to new markets, followed by issues such as personnel departures and, for VCs, exit planning and, for CVCs, a need to raise further capital.

However, the responses to the 'other' category help explain why CEOs are so frequently replaced. Almost all said that a frequent reason for replacing top talent was that the company had outgrown the skills or experience of the person in question. "Evolution of company from pure start-up to development, then rapid growth phase – different skills are required for each of these phases," said one respondent.

This demonstrates how difficult it can be at the outset of an investment to assess how far a CEO or other member of the senior team can grow with the company. Yet for very early-stage ventures in particular, replacing a CEO during the course of an investment is not uncommon. "We are very clear with portfolio company management at the outset that this may happen," says Ignaas Caryn, Director of Innovation and Corporate Venturing at KLM's Mainport Innovation Fund. "We find that the founder of the company may not be the right person in two to three years' time. We have this discussion up front."

There are alternatives to replacing a CEO, according to some seasoned investors. One of these is bolstering talent around him or her to plug experience or skills gaps. "We put a lot of effort into coaching and developing senior people in our portfolio companies," says Roel Bulthuis, Managing Director of MS Ventures. "And while there may be good examples where a CEO needs to be replaced – such as if they are great project leaders in R&D and development, but don't have the skills to lead a company in the biotech industry – it's a disruptive thing to do. Our approach is usually: can we help someone grow with the business?"

"Many good CEOs recognise that as the company grows, there is a need to bring in supplementary skills and people who can take away the work they find less interesting. It's a case of building the team around them and being able to convince the founding team that the time is right for new talent recruitment."

Egbert Bierman,
Investment Director,
Transamerica Ventures

Some VCs also have specific programmes to help CEOs develop further. At Octopus Ventures, for example, the experience of portfolio companies is pooled. "We want to be known as supportive investors and we spend a lot of time thinking about how we can help them become successful," says the firm's George Whitehead. "We can nudge CEOs into specific programmes or provide mentors, and we have venture partners who can support companies. We also have a peer-to-peer system whereby CEOs or other senior team members can ask others in our portfolio for advice and help as there is bound to be someone who has faced similar issues."

IN CONVERSATION WITH
STUART CHAPMAN, CO-FOUNDER, DFJ ESPRIT

Stuart has many years' experience of investing in young, innovative companies. He co-founded DFJ Esprit in 2006 and the firm has since made investments in over 30 businesses. Prior to that, he was a partner at 3i Ventures and enjoyed four years in the firm's Silicon Valley office.

WHAT DO YOU LOOK FOR IN LEADERSHIP TEAMS?

"The biggest factor in leadership for us is the ability to lead. To sell the story, so that people believe you and want to follow you. Leaders need to be able to explain why their offering is better than the rest and take the whole team with them (fellow directors, employees, investors, customers, etc.).

"And, while the leadership team is critical, given the early-stage nature of our investments, this has to be backed up by really great technology, huge market potential – otherwise we just won't see the potential for growth that we're looking for."

AND HOW COMPLETE DO YOU EXPECT THE SENIOR TEAMS TO BE?

"We never back complete leadership teams – the companies are usually too early in their development to have the full complement of skills. What's much more important to us is that the senior team recognises the skills they will need as the company grows and develops. We're more interested in those that have the foresight to identify and understand that they'll need, for example, a VP of Engineering to complement the CTO post-investment. To my mind these teams are far more backable."

HOW DO YOU ASSESS THE SKILLS OF SENIOR TALENT IN A PORTFOLIO COMPANY?

"I've been investing since 1992 and I've seen so many fads come and go – qualitative analysis, quantitative analysis, 360-degree feedback, and so on. There is no clear winner in any of these in my opinion and they can't be a substitute for lifting the lid and understanding what experience a person has, what their colleagues and/or employees say about them and getting to the bottom of what they have actually achieved in the past.

"Over a long career I have made a lot of hiring mistakes; we once hired someone who we thought was a big shot from the US. He built a team around him of people he'd worked with before; the investors backed the story. By the time it had all gone wrong, it emerged that his previous role had not been as a CEO – he had simply managed sales teams. That's a very different role from, for example, getting stuck in, managing relationships in a small team where the CTO might have a differing perspective about the technology from the sales director. That was a big lesson about getting seduced by CVs. Now, I'd look for someone in that role who had got a product from zero to £10m rather than £30m to £50m, for example."

FINDING ENTREPRENEURIAL TALENT EMERGED AS A BIG ISSUE FOR MANY RESPONDENTS. WHAT'S YOUR TAKE ON WHY THIS IS SUCH A CHALLENGE?

"Well, I don't think it's because there is a lack of it – there is actually an abundance of raw entrepreneurial talent. I often advise students to go and work in a 20-person company if they want to hone their entrepreneurial skills. That will help them much more than going into a large services organisation, as many do.

"I think it has much more to do with the fact that it is a hard and bumpy road to be an entrepreneur. You have cash flow problems as an early-stage company, few customers and minimal reference points in the market. It's a stressful undertaking to be a senior person in a young, entrepreneurial company."

IN YOUR EXPERIENCE, WHAT IS THE BIGGEST CHALLENGE ASSOCIATED WITH INTERNATIONALISING PORTFOLIO COMPANIES?

"It's a pretty basic issue but an important one. You need to hire good people internationally and, going back to what I said earlier about lifting the lid on what people have actually done to date, it is that much harder in a different country. If you were appointing in the UK, you understand people's successes and achievements. You don't know what the benchmarks are for success locally and you don't know how they are codified. That's why we try and provide mentors and ex-CEOs locally to help portfolio companies navigate recruitment in new markets."

HOW DO YOU MANAGE THE ISSUE OF COMPANIES OUTGROWING THE SENIOR TEAM MEMBERS' CAPABILITIES?

"You have to be open about this from the outset. You have to be clear with the individual(s) concerned that if the company is going to grow to a certain point, it will either need a new team or existing team members will need training and coaching. We'd far rather the individuals grew with the company because replacing them is so disruptive. If we find that, following training, they are still not suitable, we try and work with where their strengths lie to fit them into a suitable role.

"But the key is doing this two years before the skills gap becomes a problem – the long lead time gives the individual enough time for appropriate training and the company adequate time to find a replacement if necessary."

AND FINALLY, OUR SURVEY SHOWS CLEARLY HOW DAMAGING IT CAN BE TO MAKE THE WRONG APPOINTMENT. HOW CAN YOU MITIGATE THE RISK OF THIS HAPPENING?

"Have knowledge and understanding of who you are bringing in. That either comes from personal experience with individuals or, if you are using a search firm, make sure you have a good, long-term relationship with them. The problem is, if a search firm or you see the relationship as a transactional one and the firm doesn't really understand the needs of the business (and the characters involved), you run a greater risk of bringing in the wrong people."

SOURCING AND ATTRACTING TALENT

Getting the right senior talent on board is essential to company development. There have been many studies suggesting that talent gaps are major barriers to growth, but we wanted to delve deeper into the question of why this might be and what issues early-stage companies face when seeking to bring in new people at a senior level.

Our study adds to the evidence that finding the right people is difficult and has a significant impact on the success of a portfolio company. When we asked respondents what the barriers were to company growth, finding talent emerged as the greatest, with 81% saying this was either a major or moderate barrier (see Figure 5). This was followed by customer demand and competitive marketplace, with 77% and 76% respectively. Financial restrictions and international expansion also ranked highly.

There were some subtle differences between the responses of CVCs and VCs, which can largely be explained by the differing aims between the two types of investor (see Figure 6). CVCs were more likely to rank competitive marketplace as a major barrier

FIGURE 5
TO WHAT EXTENT DO YOU REGARD THESE FACTORS AS BARRIERS TO GROWING YOUR PORTFOLIO BUSINESSES?

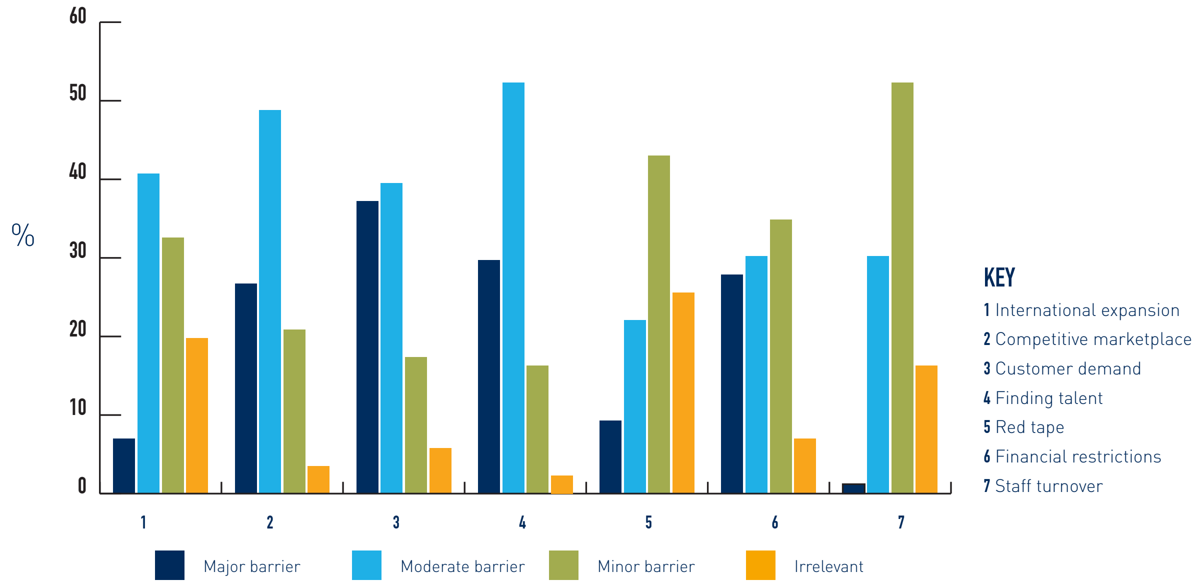
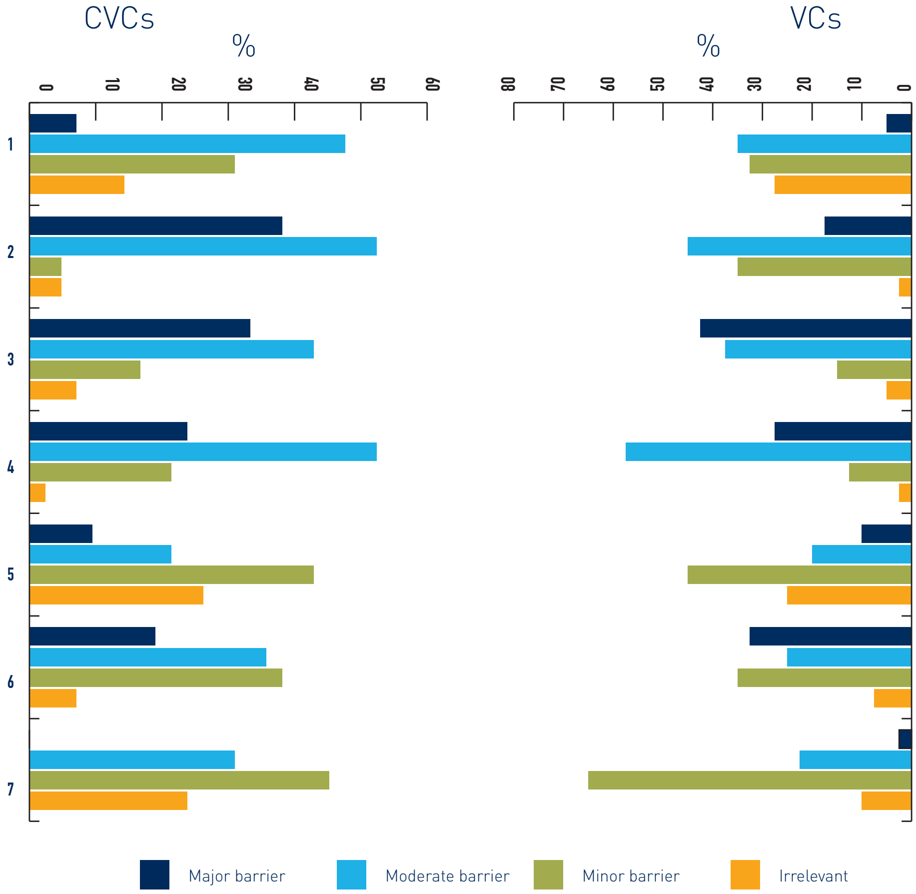


FIGURE 6

TO WHAT EXTENT DO YOU REGARD THESE FACTORS AS BARRIERS TO GROWING YOUR PORTFOLIO BUSINESSES? CVCs v VCs

KEY

1 International expansion
2 Competitive marketplace
3 Customer demand
4 Finding talent
5 Red tape
6 Financial restrictions
7 Staff turnover



than VCs (with 38% of CVCs saying this versus 18% of VCs), possibly because of their focus on strategic goals. VCs, meanwhile, cited financial restrictions more commonly than CVCs as a major barrier, with 33% citing this against just 19% of CVCs.

ENTREPRENEURIAL AND SECTOR EXPERTISE HARD TO FIND, BUT CULTURE IS KEY

CVCs and VCs are looking for specific skill sets in their senior teams. Not only do these individuals need to be able to lead their company into new markets and spot new opportunities, but they must also fit well with the existing personalities within the company and be able to deal effectively with investors.

The biggest issues when searching for top-level talent cited by all respondents were finding people with entrepreneurial experience or mindset and cultural fit, with 84% saying these were major or moderate challenges (see Figure 7).

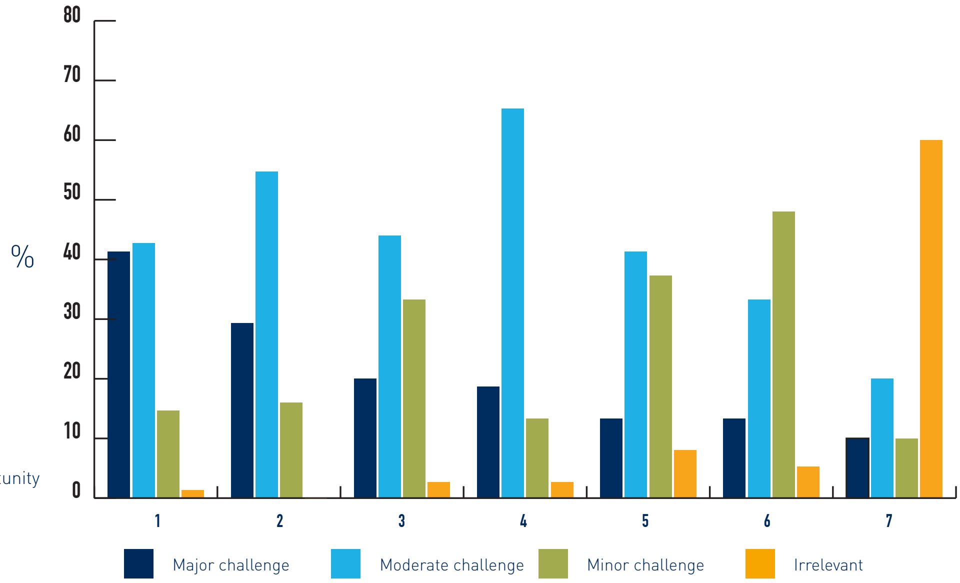
VCs tended to cite entrepreneurial talent as a greater issue than CVCs: half of VC respondents said this was a major challenge versus 31% of CVCs. CVCs, meanwhile, said that finding people with the right sector knowledge was a bigger issue for them, with 33% citing this as a major challenge (versus 26% of VCs). Again, this is reflective of the greater strategic focus of CVCs, leading them to seek out people with more experience of a particular sector, especially if the company is operating in a slightly different segment of the market from the one in which the parent currently does business.

The issue of finding entrepreneurial talent is more nuanced than simply looking for people with experience of setting up businesses – it's about having the right balance of skills. George Whitehead of Octopus Ventures explains: "It's hard to find people with the right mindset, but not because there is a dearth of entrepreneurs," he says.

FIGURE 7
HOW CHALLENGING WOULD THE FOLLOWING BE TO YOUR PORTFOLIO BUSINESS WHEN SEARCHING FOR THE RIGHT TALENT AT A SENIOR EXECUTIVE LEVEL?

KEY

1 Finding people with entrepreneurial talent
2 Finding people with the right sector expertise
3 Ability to offer a compelling package
4 Cultural fit
5 Finding people with international experience
6 Ability to offer a compelling enough career opportunity
7 Other



"In fact, the incubators are filled to capacity with entrepreneurs. Rather, it's about finding that rare breed of individual that can lead hypergrowth in a company – they know what it takes to build something of scale."

When it comes to culture – and this is in many ways allied to the issue of having an entrepreneurial mindset – the individual must be able to build good relationships with the founders as well as the broader team. Most respondents felt that, given the small size of portfolio companies, cultural issues really do count. "We recently recruited for a portfolio company CEO where the incumbent was reaching retirement age," says Ignaas Caryn of Mainport Innovation Fund. "We knew that the two individuals would have to get on well on a personal level. The other issue is that if you're recruiting during the investment, you're bound

"I don't think that finding people with an entrepreneurial mindset in technology is that difficult – especially as it's easier and cheaper now than it ever has been to become one, as the cost of development has reduced so much. I'd say that finding good people with commercial acumen alongside an entrepreneurial mindset is actually the challenge."

Richard Hill,
Stonehage FF&P

> **"The equity incentives are built in, but the fact is that our current fund is a seed stage fund so the portfolio companies can't afford to pay the salaries necessary to attract the most experienced people from day one. In addition, they might also not yet be interested at such an early stage. We have to structure packages very carefully."**
>
> Ignaas Caryn,
> Director of Innovation and Corporate Venturing at KLM,
> co-founder of the Mainport Innovation Fund

to have teams that have largely come from technology backgrounds and, if you're bringing in someone more commercially focused, there can be friction. This has to be managed very carefully but also with rigour."

In CVC-backed portfolio companies, there may be a slight tendency towards bringing in people with corporate experience at some point in their careers and therefore with an appreciation of the strategic aims of the parent. "Management teams of CVC-backed companies do need to have some understanding of the corporate parent's culture," said a corporate venturing respondent. "Things move more slowly than in an entrepreneurial company and there are more constituents to satisfy. It can be challenging, but that is down to the CVC unit to manage this."

Nevertheless, most respondents commented that the fact that most CVC capital is co-invested with VCs means that there is usually little difference between the types of individual brought into portfolio companies.

One of the other issues highlighted by our survey in bringing in the right talent to portfolio companies is the ability to offer a compelling compensation package. Although ranked as less of a challenge (64% of respondents cited this as a major or moderate issue), this does present problems in the type of young company backed by CVCs and VCs. While equity incentives are used by both types of investor, remuneration was frequently cited as a barrier to attracting top-level people of the right calibre.

"Financial resources can be problematic, particularly if you are talking about spin-off situations," says Roel Bulthuis, Managing Director of MS Ventures. "We are often faced with a difficult balance between getting the best senior team and the need to preserve capital for development. That often means we take more junior talent on board and then spend a lot of time coaching them to help them grow with the business."

BUILDING THE RIGHT PROCESSES

The vast majority (88%) of respondents said that finding candidates with the right skills and experience was a major or moderate challenge (see Figure 8).

This was followed by making an appointment within the requisite timeframe, cited as a challenge by 67% of respondents, reflecting the fact that young companies need senior talent quickly to be able to take advantage of market opportunities and plug gaps swiftly. Yet this high response rate is also likely to be because it takes time not only to source the right people, but also for them to work out notice periods and manage other commitments before they can start with the company.

Half of respondents also highlighted a need to gain agreements from other

88%

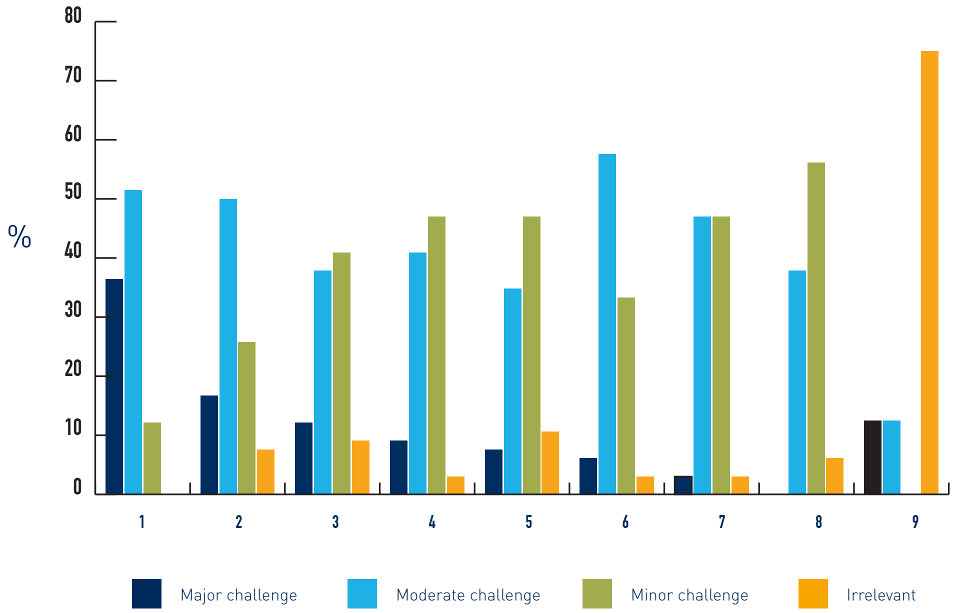
of respondents said that finding candidates with the right skills and experience was a major or moderate challenge.

FIGURE 8

HOW CHALLENGING WOULD THE FOLLOWING BE TO YOUR SENIOR EXECUTIVE TALENT STRATEGY AND PROCESS?

KEY

1 Finding candidates with the right skills/experience
2 Making an appointment within the requisite time frame
3 Gaining agreement from stakeholders
4 Gaining interest from candidates
5 Conducting an efficient and effective interview process
6 Identifying skill gaps
7 Conducting due diligence on candidates
8 Contract negotiation
9 Other



stakeholders, including the management team members themselves but also other investors in the business. However, many respondents also commented that, with clear objectives and an identification of potential gaps at the start of an investment, this should be less of an issue. "We spend a lot of time aligning interests between the different parties at the outset," says George Whitehead of Octopus Ventures. "If you start early on in these discussions and are honest, you can tackle the issue of bringing people on board before it becomes an emotive issue, which it can at the later stages. If you have had this kind of dialogue early on, you will save yourself a whole world of trouble."

MORE SYSTEMATIC APPROACH TO TALENT NEEDED

Identifying skills gaps was another important issue for CVCs and VCs. Over 60% said this was a major or moderate challenge in their

"We work closely with all the stakeholders in the business to assess the ongoing skills needs of the company. If we are growing a company from £1m to £10m, for example, our first discussion is around which different skills the company will need."

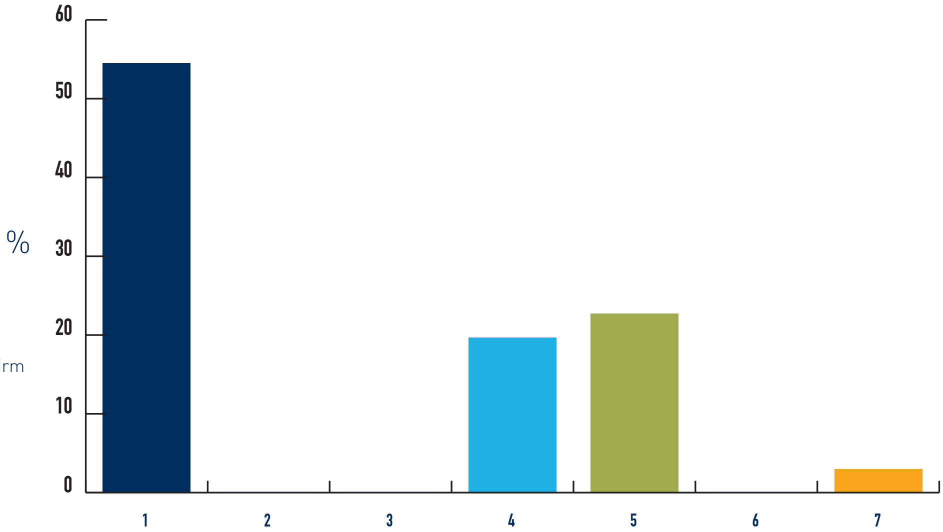
Corporate venture unit manager

FIGURE 9

WHICH ONE APPROACH TO EXTERNAL SENIOR EXECUTIVE LEVEL APPOINTING HAVE YOU FOUND TO BE MOST SUCCESSFUL TO DATE?

KEY

1 Making enquiries via own network
2 Advertising in specialist media
3 Advertising in general media
4 Working with an executive search firm
5 Working with a sector-specialist executive search firm
6 Working with a general recruitment agency
7 Other



process and strategy around top talent acquisition. This is interesting because, when asked further about this, all interviewed respondents said that discussion of talent needs in a portfolio company happened on an ongoing basis, with this item covered at every board meeting and usually more frequently than that. "This is a hugely critical issue," comments Egbert Bierman of Transamerica Ventures. "It's a source of continual discussion with our portfolio companies because the execution of a company's strategy is dependent on having the right talent on board."

Richard Hill at Stonehage FF&P adds: "We help companies assess skills on an ongoing basis. We look at what will be needed for a company to achieve its business plan and what will be needed 18–24 months down the line. Yet it's true that often early-stage companies move so quickly that planning effectively that far ahead is very challenging and so new hires tend to centre around the achievement of milestones, and, while the intention to hire is flagged well in advance of this, the process isn't started until much later."

The suggestion here is that, while investors and boards may be discussing the company's talent requirements on a regular basis, there is a need for more systematic and strategic thinking around top-level appointments. Given the timescales involved in getting the right people on board, having a well thought-through plan and acting to bring in new talent at an earlier stage than when it is actually needed, could pay off in the long run.

Finance Yorkshire, for example, has recently started compiling a management matrix post-investment to help the firm identify current skills gaps and plan for future hires. "We put together the matrix following investment and mark the team on a number of attributes, such as commercial acumen, financial literacy, dominance of particular individuals, etc," explains the firm's Paul

Gower. "This gives us a common framework through which we can draw out points of discussion with the management team."

Meanwhile, MS Ventures takes a different approach. "We usually build out teams that we back and one of the roles we insist on having early in the investment is a business development person," explains MS Ventures' Roel Bulthuis. "We bring them in before commercialisation because business development people will lay the foundations of the market for a company's product."

NETWORKS AND EXECUTIVE SEARCH EFFECTIVE FOR APPOINTMENTS

Both CVC and VC fund managers build strong networks of contacts that they can draw on for the benefit of portfolio companies. VCs in particular tend to stress the added value they can bring by introducing experienced people to young companies. It is therefore unsurprising that over half of respondents said that they had found sourcing candidates through their own network to be the most successful route to appointing senior executives (see Figure 9).

Yet 43% said that executive search firms were the most effective way of bringing in senior-level talent. This was split between general executive search and sector-specialist executive search. None of the respondents found any forms of advertising or working with generalist agencies to be a successful way of bringing in senior talent.

Given some of the barriers and challenges mentioned above, such as finding people with the right skills and experience, plus the cost of failed appointments (see next section), we wanted to find out why executive search isn't used more.

Richard Hill at Stonehage FF&P suggests that some of this is to do with finding people who are known quantities and who will be a good fit with the team. "Executive search is usually the start point for us, although there can be benefit in bringing someone in we or the team know already, particularly if the team is small," he says. "That's because culture is such a big factor in the success or otherwise of these appointments. Having people that fit in can be as important as getting someone in with exactly the right skills. We've found that if you tick all the right boxes in terms of skills and experience but they aren't of the right mindset, the appointment just doesn't work."

Many respondents pointed to the cost of hiring a search firm, particularly given the early stage of many portfolio companies and their need to preserve capital for development. Nevertheless, many also felt that bringing in a trusted search firm, provided that the company had the funds to pay for it, helped to cast the net wider and put forward good-quality candidates.

"Around half of our portfolio is mature enough to consider using executive search firms and we like to use them when we are recruiting business development or CFO positions in particular as our own networks only provide a thin layer of coverage within our sector," says Roel Bulthuis, MS Ventures. "In addition, even if we do have people in our networks that might be suitable, I'm not always sure that we can approach them because of potential conflicts of interest."

"Networks can save money for small start-ups," says Paul Morris of UKTI. "But if you know and trust an executive search firm, this can be a good way of sourcing candidates – you don't know for sure that your network will offer you the best person for the role."

George Whitehead of Octopus Ventures agrees: "Often people settle for those in their networks rather than asking whether they are the best person for the job. We do always start with our networks as they can be hard to beat, but if you are trying to build a global business, it's really worth supplementing those networks with a good search firm to test whether you have found the best person – second best isn't really good enough."

43%

of respondents said that executive search firms were the most effective way of bringing in senior-level talent.

RETAINING SENIOR TALENT

Given the difficulty of finding and attracting the best talent in senior teams for portfolio companies, the issue of retention is an important one. When asked which were the most difficult aspects of retention, respondents across both types of investor ranked the lure of a larger compensation package as the biggest challenge, with 81% of respondents saying this was a major or moderate challenge, followed by the lure of joining a higher-profile business, with 64%, and cultural fit, with 45% (see Figure 10).

There were some differences between the VC and CVC responses, however. While larger compensation packages were the biggest challenge for both groups, CVCs cited the lure of joining a higher-profile business as the second biggest challenge, with 79%, and career progression as third, with 44%. VCs, on the other hand, cited cultural fit as the second biggest challenge (54%) and the lure of joining a higher-profile business as third (48%).

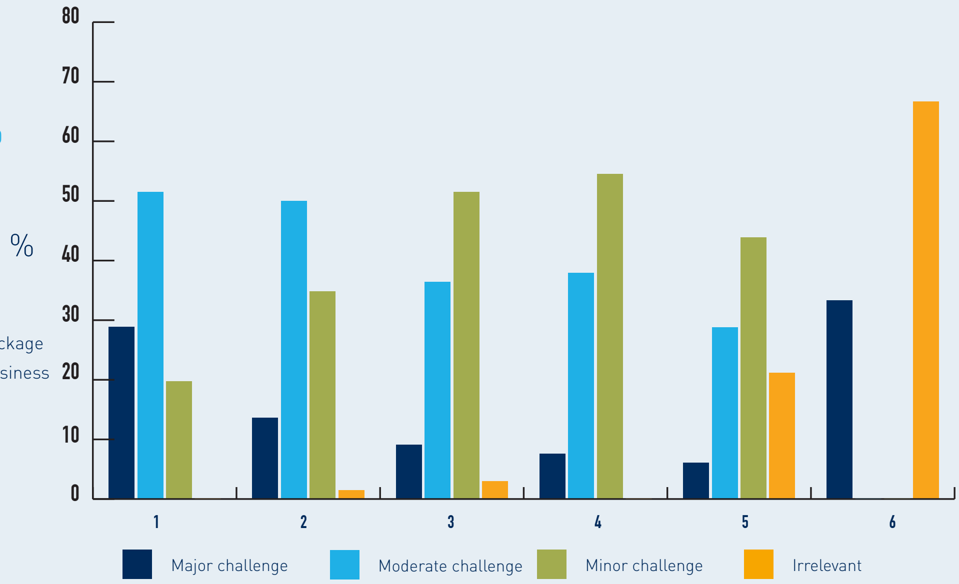
Many commented that retention tended to be an issue when the company wasn't performing to plan. "Sales directors can be lured away if the company is not doing that well," says Paul Gower of Finance Yorkshire. "And FDs are sometimes attracted to working in larger companies."

Yet in other cases, regular discussions around equity incentives, together with building a good culture, should help prevent retention becoming an issue. "We spend a lot of time funding great people," says George Whitehead at Octopus Ventures. "If the company increases in value, so does the value of the people running it – share options should be designed to make sure all interests are aligned, and people need to be inspired and want to work within the organisation. In addition, we can also help management have partial exits along the way as the company attracts further funding rounds – often we see people work very hard to build a business that is very valuable but without liquidity, this value is all on paper. Allowing them, and their families, to feel the financial benefits of success along the journey can make a real difference and inspire people to continue to keep up the pressure necessary to build a world-class business."

Ignaas Caryn of Mainport Innovation Fund adds that he hasn't encountered any serious issues with retention. He puts this down to the way investments are structured and managed. "In our portfolio, the entrepreneurs keep a majority stake," he explains. "And when new people join, we make sure they have a decent stock option package. But retention is also to do with the ongoing relationships we as an investor have with management – we want to be complementary and support the team."

FIGURE 10

HOW WOULD YOU RATE THE FOLLOWING AS POTENTIAL CHALLENGES YOUR PORTFOLIO BUSINESSES MIGHT FACE WITH REGARD TO RETAINING TALENT?



KEY

1 The lure of a larger compensation package
2 The lure of joining a higher-profile business
3 Cultural fit
4 Career progression
5 Glass ceiling
6 Other

TALENT IN CORPORATE VENTURE CAPITAL UNITS

Getting the right people to manage investments in corporate venture capital units is a well-known challenge. Not only do these individuals need the skills to be able to assess and monitor portfolio companies, but they need to have a good understanding of what the parent company is trying to achieve through the investments it makes. In addition, they may need technical knowledge to supplement these two attributes. Given that most CVCs are small teams – nearly half of respondents had five or fewer staff – making the right hires is vital for the success of a venture programme.

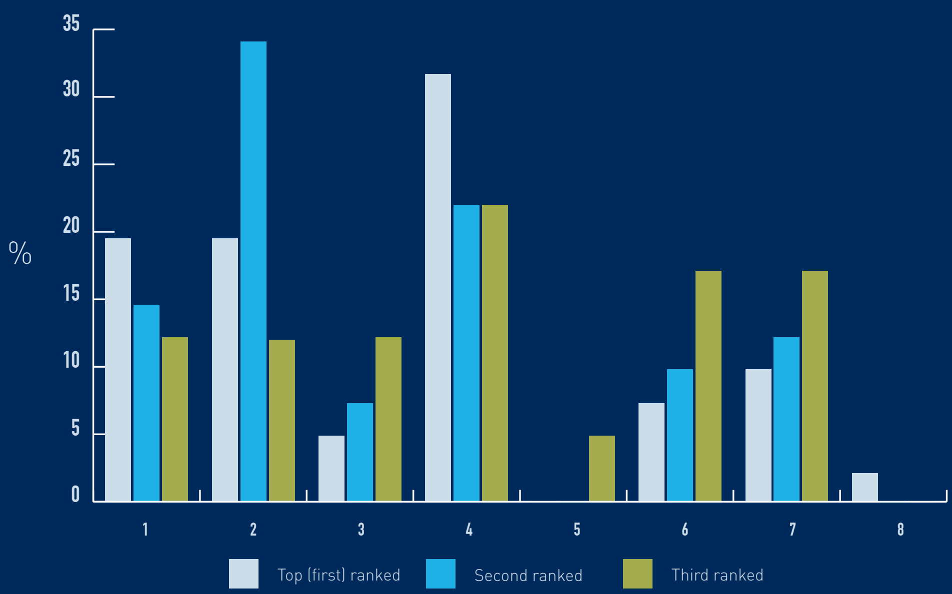
We sought to find out what CVCs were looking for when recruiting for their venture units and where they sourced candidates from. The most important attribute CVCs seek is financial investing experience, with 75% of respondents ranking this as a top three requirement (see Figure 11). Sector experience is also highly valued, with 66% putting this in the top three, followed by knowledge of the parent group and its strategic goals with 46%. However, both cultural fit and entrepreneurial experience are also important considerations.

CVC staff need to operate successfully as investment professionals, but within a corporate framework. This is reflected in the split between CVCs, who felt that bringing someone in from the parent group and teaching them financial investing skills was easiest (41%), and those who thought hiring in someone with a financial investment background and teaching them the culture of the parent group was the preferred route (54%). The preference for bringing in those with financial investing skills was mirrored by the finding that identifying the right talent was the biggest challenge for recruitment (44%) – corporates are clearly attempting to find people beyond their more usual, sector-based networks.

Nevertheless, attracting and retaining talent are both key challenges for corporates (cited by 37% and 19% of respondents). Unlike the financial investing environment, the payment of carried interest and other such incentives are rare in the CVC world and so getting financial investors on board presents a particular challenge for corporates.

FIGURE 11
WHICH OF THE FOLLOWING ARE THE THREE MOST IMPORTANT FACTORS WHEN RECRUITING INTO THE VENTURE UNIT?

KEY
1 Knowledge of the parent group
2 Sector experience
3 Relationship/stakeholder management
4 Experience of financial investing
5 Specific geographical experience
6 Cultural fit
7 Entrepreneurial experience
8 Other



THE COST
OF FAILED
APPOINTMENTS

Finding the right talent at a senior level is clearly a major challenge for many portfolio companies. Despite the best efforts on the part of management teams and their investors, the wrong appointments can be made. But what is the cost of this?

Our survey shows that failed senior appointments are common, with 91% of respondents having had experience of an unsuccessful executive appointment during their career (see Figure 12).

The cost of this is not to be underestimated. A large proportion (46%) of respondents said that a failed appointment costs on average between 10 and 30% of lost annual growth in a portfolio company, with a fifth saying the average was rather higher – between 30% and 60% (see Figure 13). This represents a significant setback for portfolio companies, most of which will be young, earlier-stage businesses whose model and investor backing are predicated on fast growth.

When asked further about what, specifically, the effect of a failed appointment has on a portfolio company, 80% of respondents said the business always or frequently failed to achieve business plan forecasts, 73% said the company always or frequently missed commercial milestones and 67% said that management distraction always or frequently led to lost opportunities (see Figure 14).

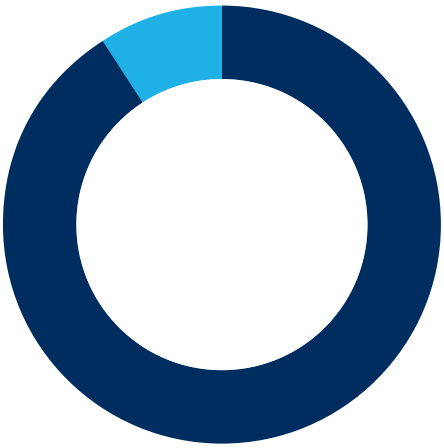


FIGURE 12
HAVE YOU EVER EXPERIENCED A SITUATION WHERE AN UNSUCCESSFUL SENIOR EXECUTIVE APPOINTMENT HAS BEEN MADE IN A PORTFOLIO BUSINESS?

Yes
No

FIGURE 13

IN TERMS OF LOST ANNUAL GROWTH POTENTIAL, WHICH OF THE FOLLOWING REPRESENTS THE AVERAGE COST OF AN UNSUCCESSFUL SENIOR EXECUTIVE APPOINTMENT TO A PORTFOLIO BUSINESS?

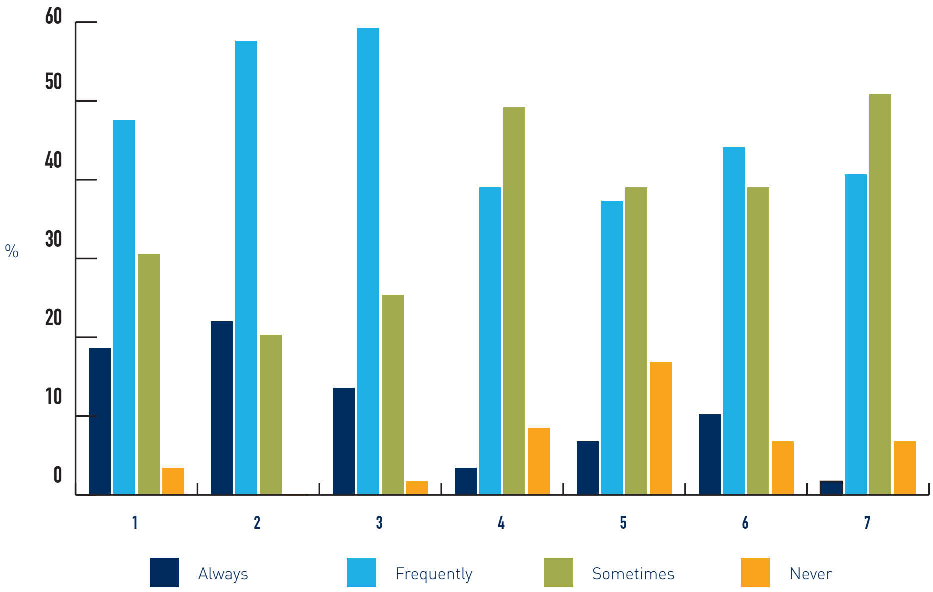
- Wouldn't make a difference
- 10% lower growth
- 10–30% lower growth
- 30–60% lower growth
- 60%+ lower growth

FIGURE 14

WHERE AN UNSUCCESSFUL SENIOR EXECUTIVE APPOINTMENT HAS BEEN MADE IN A PORTFOLIO BUSINESS, HOW FREQUENTLY MIGHT THE FOLLOWING OUTCOMES OCCUR?

KEY

1 Management distraction
2 Business fails to achieve forecasts
3 Missed commercial opportunities
4 Other staff leave as a result
5 Eventual exit plans are delayed
6 Business fails to attract funding
7 Loss of existing customers



While these were the most frequent outcomes, many of the others, such as other staff leaving, delayed exit plans and a failure to attract further funding, were all cited as significant issues.

While respondents said quantifying the cost of having the wrong person at board level was difficult, the impact is clearly serious, particularly in a small fast-growing business, where the actions of an individual really matter. This message comes across loud and clear in our survey. "In start-ups the appointment of an unsuccessful senior executive can lead to what is effectively a restart – assuming you manage to avoid a complete failure of the business, that is," said one respondent. "The valuation of a restart is inevitably much lower than you would like, meaning that the value of your original stake is severely affected."

Another said: "With failed appointments, the portfolio company gets out-executed by the competition, despite a potentially better strategy at the beginning. Other problems include underperforming staff, and/or resignation of good, but undermotivated talent; poor focus – limited resources allocated to pursuing less strategically important goals."

George Whitehead of Octopus Ventures adds: "The impact mainly comes down to time and, when you're talking about a fast-growth business, wasting time can damage a business irreparably. The damage occurs not just because of the wasted burn rate, but also through giving competitors the opportunity to gather strength and be the first to scale."

SURVEY METHODOLOGY AND SAMPLE

This report is based on the results of an online survey, supported by a selection of telephone interviews, completed in March and April 2015. It includes the views of over 100 respondents based principally in Europe and the US who manage portfolios of investments on behalf of corporate venture capital (CVC) units or venture capital/private equity (VC) firms targeting early-stage or growth companies. The split between the two types of investor was 48% CVCs and 43% VCs, with 9% classified as 'others', who were mainly advisors to CVCs and VCs (see Figure 15). The respondents are experienced investors in portfolio companies, evidenced by the fact that over four-fifths had portfolios of more than six businesses and over a third managed portfolios containing 21 or more companies (see Figure 16).

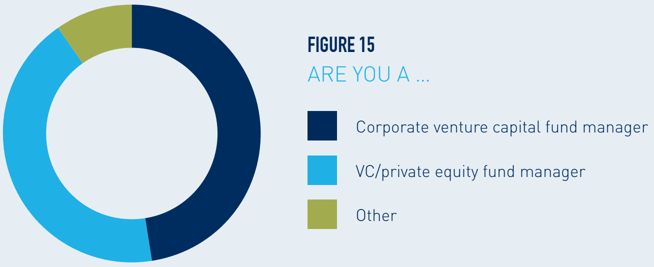
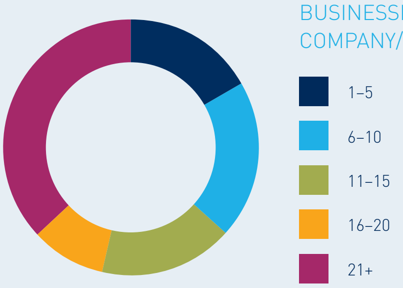


FIGURE 15
ARE YOU A ...

FIGURE 16
HOW MANY PORTFOLIO BUSINESSES DOES YOUR COMPANY/FIRM HAVE?



CONCLUSION

Young businesses clearly need to focus on how best to grow the company, from fine-tuning product and service development through to generating new sales leads and addressing new markets. With small teams and so much to do, it's hardly surprising that talent management often falls down the list of priorities. Yet, as our survey demonstrates powerfully, having a high-quality leadership team is vital if companies are to achieve the growth they are aiming for. It also shows how badly things can go wrong if the wrong person is brought on board.

As investors in innovative companies, VCs and CVCs are well placed to support their portfolio companies to manage senior talent effectively. After all, they have a wealth of experience and a wide range of contacts they bring to bear for the benefit of their investee companies. Nevertheless, our survey shows that more could be done to put in place effective processes and strategies that would improve a company's chances of attracting the right talent.

Fast-growth companies should not adopt the highly formalised practices of their larger, corporate cousins – they are evolving too quickly to set these processes in stone. But, if high-growth companies and their investors were more systematic in their approach to talent, they would see a positive impact on their growth trajectory.

These are some of the lessons to draw from the survey results:

1. **Act early.** It's clear from our survey that investors expect to build out leadership teams following investment. The skills gaps identified during the due diligence process will usually help inform decisions about which roles will need to be filled in the earlier stages of investment. Yet as the company begins to grow rapidly, it seems that investors and leadership teams struggle to think about the need for talent as far as two years out. Given the length of time it can take to get the right people on board, or to develop existing talent, there is a need to get the ball rolling as early as possible.

2. **Be honest from the outset.** That means being open with co-investors and the existing leadership team about what skills are likely to be needed during the investment period. Agree up front how best to address skills gaps and ensure all parties are aligned on this issue. Plans may change, but as long as there is regular discussion around these, this level of openness helps avoid future disagreements.

3. **Engage in talent mapping.** Define roles and responsibilities clearly, identify the right key performance indicators and align these to business objectives. This makes it easier to spot potential gaps early and helps determine ways of dealing with issues such as succession planning, development and recruitment before they become a problem.

4. **Understand the company culture.** Define what the company stands for and

understand how leadership drives this. Ask both internal and external contacts their views to gain rounded and objective insights. This helps articulate what the company culture is – which is helpful in itself – but also makes it much easier to source and attract talent that fits with the existing team. Nevertheless, this doesn't mean creating a cosy culture led by like-minded individuals – performance should be at the heart of company culture, with the challenging of assumptions encouraged.

5. **Invest in training and development.** Businesses often outgrow the capabilities of leadership teams – hence the high response rate for changing CEOs in our survey. However, replacing key executives isn't always the best approach and can be highly disruptive. Put in place programmes, such as mentoring or formal training, so that talent can be developed for the company to achieve its strategic goals.

6. **Use non-executives to complement leadership's skills.** Non-executive directors bring not only a wealth of experience in particular areas and an objective viewpoint to board meetings, they can also be used to help coach members of the leadership team and provide support where executives' skills may be lacking or under development.

7. **Keep your A-team.** Identify the individuals who are critical to the business and keep hold of them. Discuss their motivations regularly and address these while building a team around their core skills.

8. **Think ahead and aim high.** When seeking senior talent, consider where the business will be in two to three years' time and look to hire people capable of managing the business at that point and beyond. Be ambitious about the calibre of people you want to attract and search for them accordingly. However, that doesn't necessarily mean bringing in a corporate big-shot – they may lack the hands-on experience and skills that entrepreneurial businesses need.

9. **Be flexible around incentives.** Think creatively about how best to incentivise key leadership team members. Stock options are clearly important, but if the value created on paper is going to be locked up for a significant period of time, executives may need partial exits as new rounds of funding are attracted.

10. **Never settle for second best.** Poor executive choices lead to poor outcomes. This is especially the case when time is of the essence, both for the company to gain a lead on competitors and for investors' exit horizons. Take an exhaustive approach to finding the best executives to lead ventures to ensure you really are bringing the best talent on board.

ABOUT INTRAMEZZO

Intramezzo is an executive search and interim management firm, specialising in working with corporate and VC/PE portfolio companies.

We have been helping companies achieve their global growth ambitions through the provision of world-class board and C-Level talent since our inception in 2002.

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