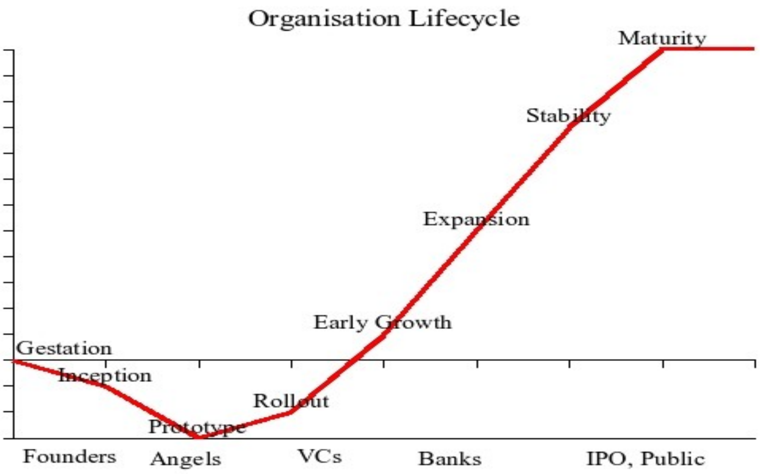
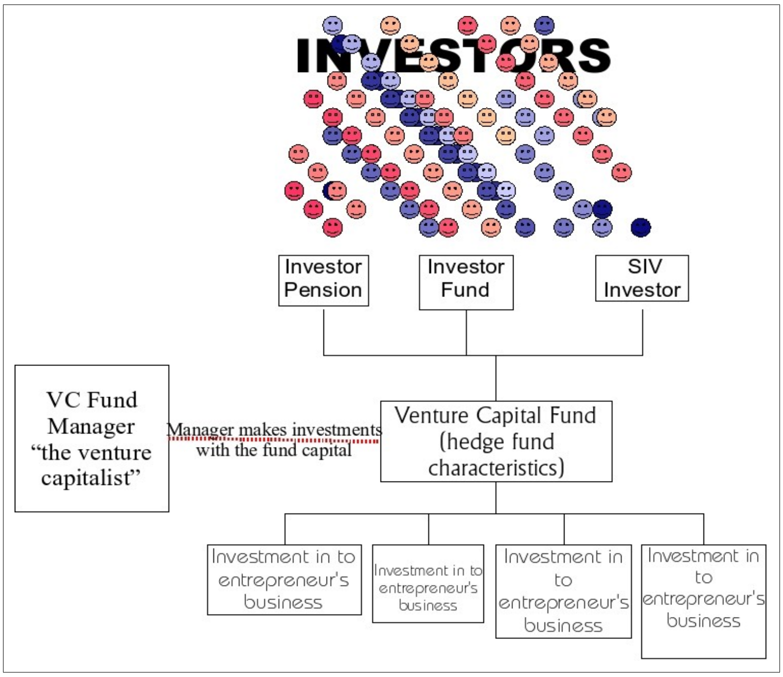
Astraea

Enlightening Venture Capital
- reducing risks with consciousness technology

The real problem with venture capital is that it reduces flexibility when its most needed. In a perfect world a venture capitalist would be the entrepreneur's partner, guide, mentor and friend as well as financial controller. In the real world, the VC, while providing cash, is also likely to raise the pressure in an already bubbly cauldron. It needn't be that way. Choose a venture capitalist with a business approach more evolved than those financiers with a basic instinct for numbers on paper but little attention to business nurturing.



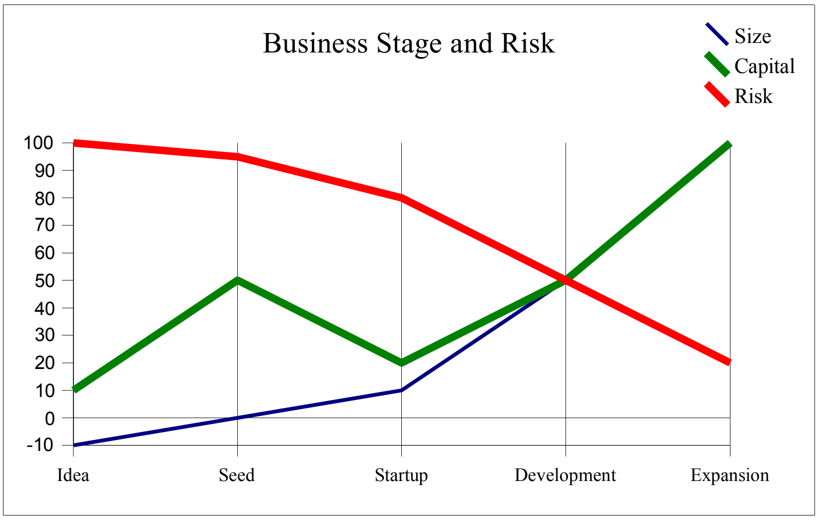
Venture capital (VC) is financing for risky business. Usually the business is in the early part of its life-cycle so there is much uncertainty about the business outlook. Risks are many. There may be new technology involved in the product, its production or delivery. The product may be a new concept in the market and therefore it is uncertain whether anyone wants it, let alone is willing to pay for it. The people in the business may not have worked together before, and perhaps have not even done the kind of business they are embarking upon. And because the business is in the early stage of growth, many things can go wrong for the first time and unexpectedly.



In to this very risky business proposition, the entrepreneurs need to provide assets, both working and fixed capital, to build the business.[i] If they are not putting their own money up, they must find it elsewhere. Family and friends will often help at the beginning but before long, other people's money will be needed. Normally banks will be the last group to provide capital for the business itself, and will only do this if it is secured. If banks lend, its only because they are getting security elsewhere, such as the entrepreneur's house or another income flow or a guarantee from a related company or person. So the entrepreneur needs someone else to share the core risk, the unsecured risk. This is the venture capital.

There must be something about the arrangement to induce someone to put unsecured cash into a risky business. VC investors are willing to invest, in the knowledge that they could lose everything, because they want a better much payback than if they put the money in to a bank deposit. And usually they want to be alive when they get the cash back. So the VC investor wants a high expected return (let's say 2x the stock market which would be around 15% per annum[ii]) and they want it in 5 to 8 years – the life of the fund of capital they are managing.

Now we are beginning to see how the tension is building. The entrepreneur is seeking capital to build their dream and needs it to be patient and accommodating capital, because of all those other risks she is dealing with. The venture capitalist wants a high return on capital and wants it soon (relative to the company life-cycle). The venture capitalist may only provide the cash under certain conditions, similar to those a bank might request in making a loan like maintaining a certain debt to equity ratio, current asset ratio and so on. These conditions create more tension. So the high cost of capital creates inflexibility and that is how massive tension is built up.[iii]



The entrepreneur needs support, help and flexibility to deal with unexpected problems on a day to day basis and the unavoidable diversion from business plan, such as when markets take longer to enter, regulations change or key managers leave. However, the venture capitalist creates inflexible benchmarks for business performance because that is how they expect to reduce risk and achieve objectives.

While it is certain that discipline is needed in any business, early stage or high growth businesses in particular, it is also certain that the financial inflexibility increases tension and therefore risk too. So the trouble with venture capital is that it reduces flexibility and raises risk, just when flexibility is most needed, and when the venture capital investor most wants to reduce risk!

Objectives	Entrepreneur	Institutional Venture Capital
Purpose	continuity	Maximising medium term cash returns
Goal	To build vision and reputation	To meet institutional investors expectations
Fundamental belief	The business must survive	Our money is most important
Strategic Orientation	adaptation	Constant growth
Management focus	Continuous innovation	Incremental improvement
Most important stakeholders	Customers and employees	Venture capital manager and investors
Business is seen as	A member of the family	A disposable asset

Re-Frame Thinking

Can the objectives of both entrepreneur and venture capital investor be achieved in another way? Absolutely! In the classic model described above the most effective way to ameliorate the tension is for the venture capitalist to exhibit family values, rather than corporate values, and to have people in the business who are driven by passion rather than money. They must of course have financial acumen and business experience and expertise – these are skills that they add to the entrepreneur's business and without them the VC is undifferentiated from any other provider of capital.

The table[iv] here describes some of the cultural differences between entrepreneur and institutional venture capitalist, illustrating the sources of tension that will naturally build up if not addressed.

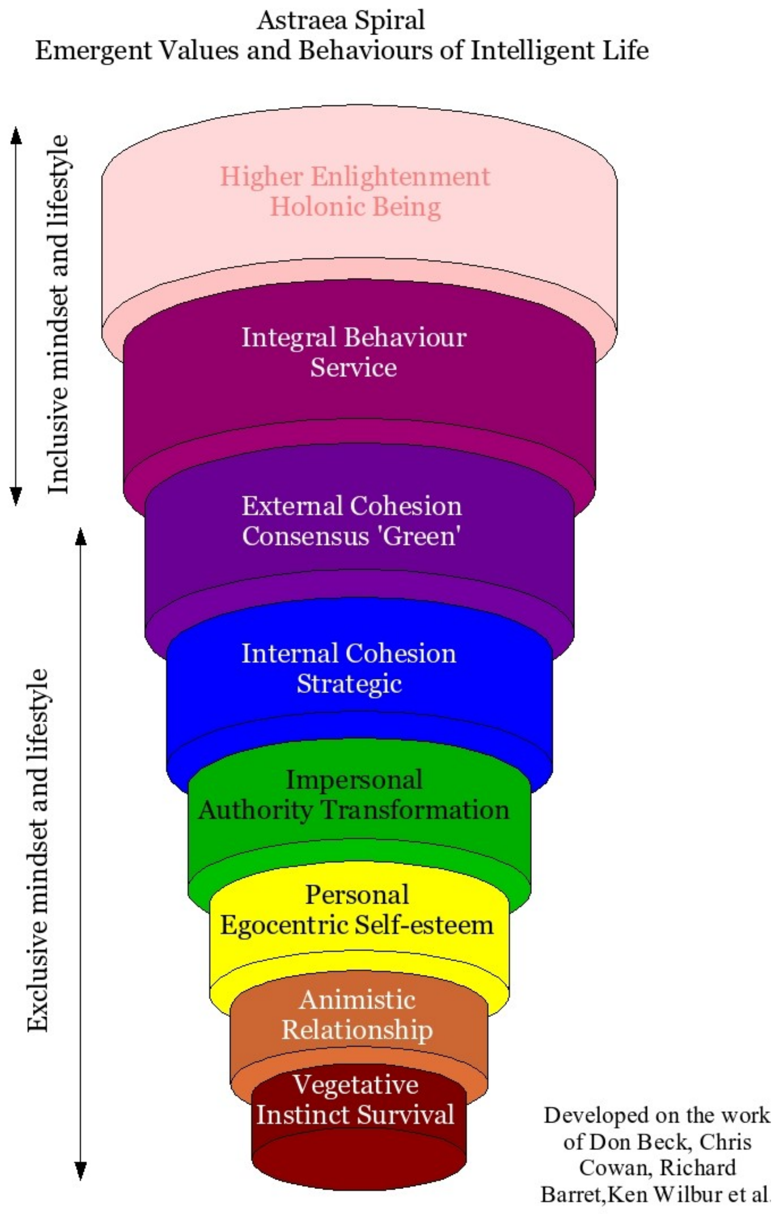
The venture capitalist must re-frame their thought process to focus on what will make the company successful. Successful business management is not achieved by creating internal pressure and reducing communication, which occurs when accounting benchmarks are used to the exclusion of fluctuating business circumstances. Success requires that the business is nurtured; that resources match the business plan, that relationships are open and that values are shared by all in the company and as many other stakeholders as possible. Then the likelihood of both investor and entrepreneur achieving success is increased. Risk is reduced, instead of raised.

As a venture capitalist, you can build skills and flexibility by imitating nature. There is no "miracle method", so you can better serve your investors and portfolio companies by open systems, multiple screens and full spectrum benchmarking. The most telling sign of whether the business is building a coherent approach is the level of diversity and productivity being created. Are offerings being improved upon by innovation from throughout the organisation (as in kaizen[v])? Are people doing more with less? If creativity and productivity is continually increasing it is likely that the culture and skills are emerging at the highest level.

As an investor, one can identify the character of the VC management approach – Do they focus on financial metrics only? Do they talk about "black box" investment methodolgy? If so, then perhaps they are missing part of the picture and should not be managing venture capital. Do they demonstrate flexibility in systems and culture? Do they prepare for change and negotiate it when it occurs? If so, they are more likely to nurture winners.

Be Human

Anthropomorphic analogy works well in screening, benchmarking and building businesses. Businesses are complex collectives with diverse organisational sophistication, also varying in size and type. A human based model is sufficiently complex, well understood and appropriate for designing and managing intelligent systems[vi]. With today's rapidly expanding understanding of psychology and its applications at personal, organisation/ business and nation levels, the tools available to nurture businesses are



sophisticated, practical and proven[vii]. The psychology of business is benchmarked against characteristics of enlightened values and behaviour to profile the organisation prognosis.

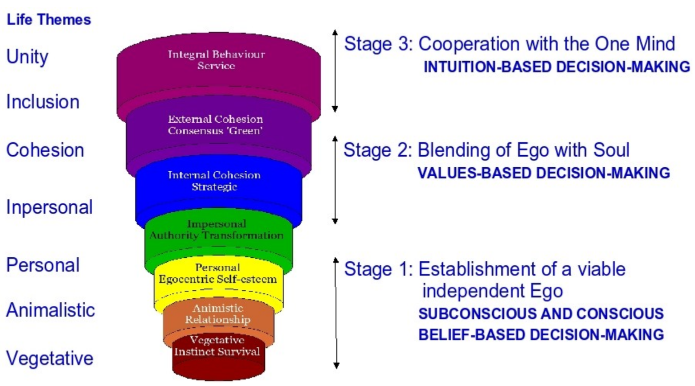
The spiral of emergent values and behaviours is based on both modern science of psychology and atomic physics and on ancient science of biorhythms and chakras[viii]. At its basic and most practical level it maps the natural progression from basal survival instinct to enlightenment. (Business practitioners will be familiar with Mazlow's hierearchy of needs[ix] which is a representation of the lower needs.)

The graphic above is a representation of emergent levels, illustrating how core survival values remain at the core of an entity's being, while higher consciousness builds upon primal needs. This consciousness model is a leading tool that shows where an organisation's character strengths and liabilities are.

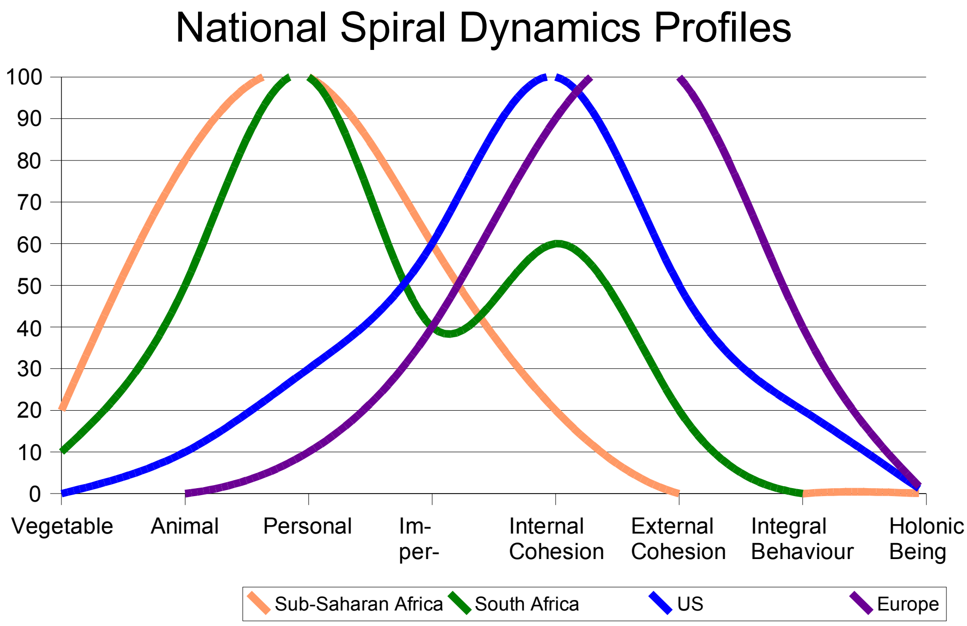
The following table describes characteristics of successive levels of consciousness (left column) for humans (middle column) and organisations (right column)[x]. (Bracketed characteristics are negative.) The colour code is based on the colours of the rainbow starting with long wavelength (red) and moving to short wavelength (violet)[xi].

Level	Human characteristics	Organisation characteristics
Holonic Being	Collective individualism, cosmic spirituality, earth changes	Natural interdependence – holarchy not hierarchy.
Integral Behaviour/ Service	Natural systems, self principle, multiple realities, knowledge	Service to Humanity – ethics, social responsibility, future generations, cooperation.
External cohesion/ Consensus	Egalitarian, feelings, sharing, caring, community	Strategic Alliances – employee fulfilment, community involvement.
Internal cohesion/ Strategic	Materialistic, consumerism, success, image, status, growth	Development of cohesive culture – commitment, enthusiasm, shared values.
Impersonal/ Authority/ Transform	Meaning, discipline, traditions, morality, rules, live for later	Continuous renewal and learning – adaptability, innovation, teamwork.
Personal/ Egocentric/ Self-esteem	Gratification, glitz, conquest, action, impulsive, live for the moment	High performance systems – pursuit of profit, productivity, efficiency, quality, professional growth.
Animalistic/ Relationship	Rites, rituals, taboos, superstitions, tribes, folk ways and lore	Routines for the organisation – communication between employees, customers, suppliers.
Vegetative/ Instinctive/ Survival	Food, water, procreation, warmth, protection, staying alive	Pursuit of revenues – financial solvency, employee productivity.
Level	Human characteristics	Organisation characteristics

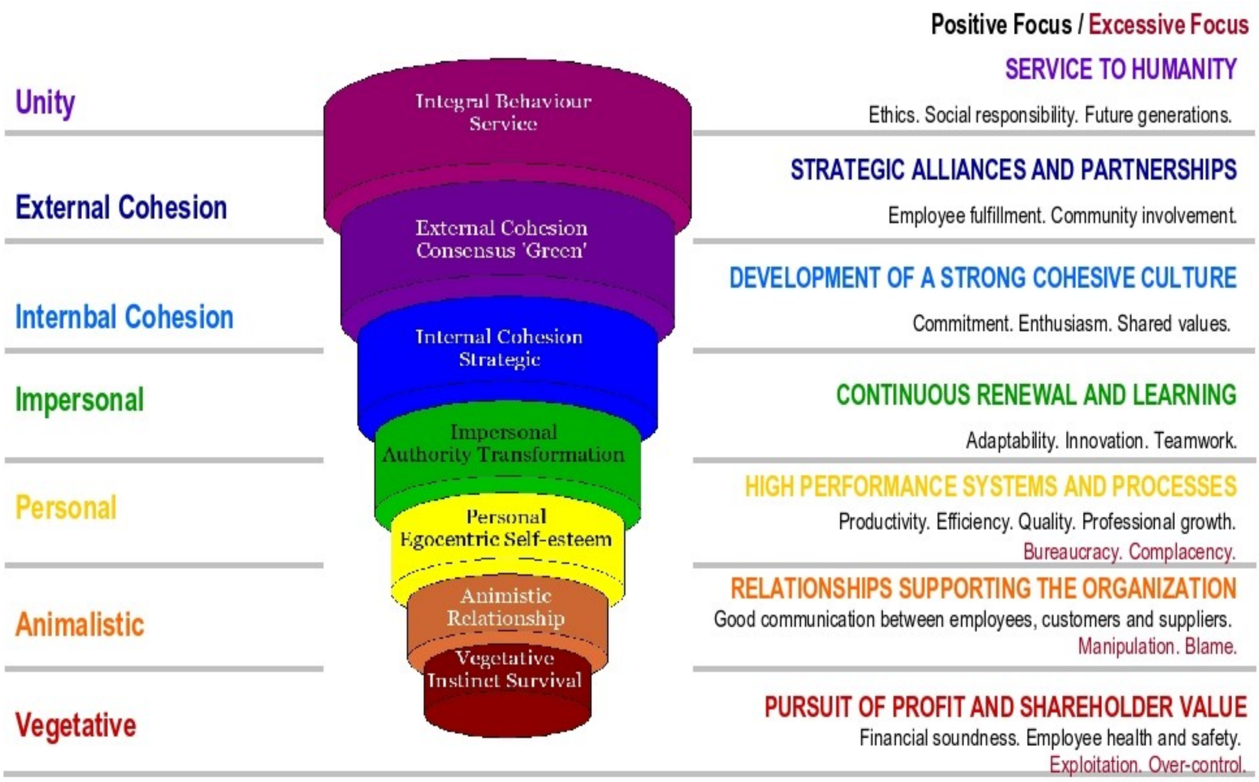
Values and behaviours in intelligent organisms (such as people or modern organisations) emerge along natural paths where primary needs are satisfied prior to ethical virtues[xii].



National values offer a convincing illustration. The adjacent table is modelled after Spiral Dynamics. You can see that the profiles match expectations. Sub-Saharan Africa peaks in the Animal/Personal character zone, South Africa has a minor spike in Internal-Cohesion, which is where USA is strongest and matches the nationalistic culture today. Europe shows signs of External-Cohesion, as expected given the EU, and leads in Integral Behaviour.



In a globally responsible manager, the higher level characteristics ought to be exhibited. This graphic below summarises the characteristics associated with business organisation consciousness. The vegtative characteristics are predominant in a startup which must generate revenues; more mature organisations will exhibit more sophisticated characteristics, such as continual renewal or partnerships.

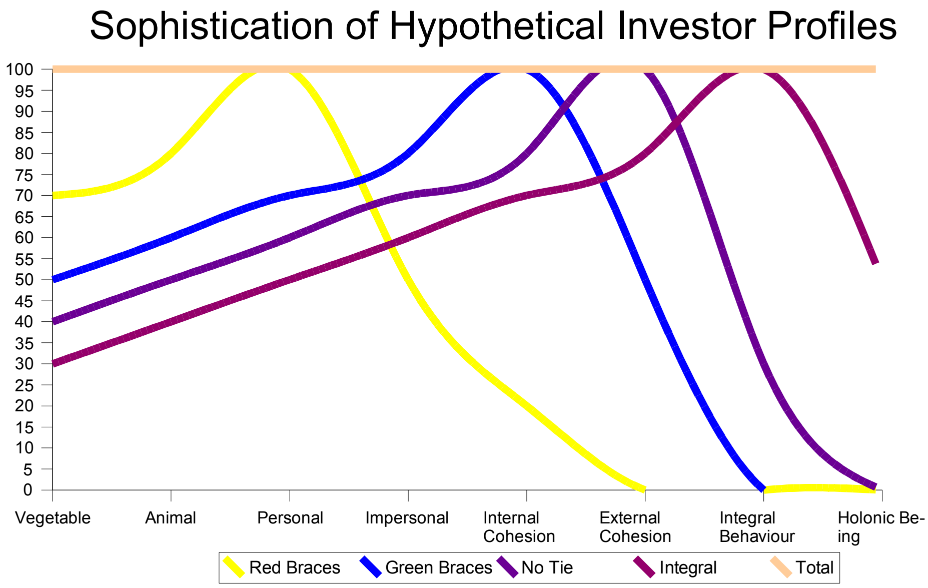


The graphic below illustrates the proto-profile of a VC investor focussing on numbers only (“Red Braces”) to one that has a broader approach (“No Tie”).

The Red Braces type of investment manager will be focussing on short term adherence to documented benchmarks. The values and behaviours that will be lacking include:

- Continuous renewal and learning – adaptability, innovation, teamwork.
- Development of cohesive culture – commitment, enthusiasm, shared values.
- Strategic Alliances – cooperation with other investors, community involvement.

Our so called No Tie type of manager will have these characteristics, but the mentality will still tend to be exclusive. They will see themselves as special and different and this will stand in the way of integrating outside their normal circles. This in itself is a limitation because managers may have difficulty integrating negatively correlated opportunities in a portfolio. The values and behaviours lacking in the No Tie manager will include:



- Global responsibility, future generations, cooperation.
- Natural interdependence – holarchy not hierarchy.

While traditional money managers may be selected from the “Red Braces” crowd it is unlikely that they will achieve long term performance. This character profile is more suited to trading roles whose performance is visible and personal. The No Tie manager is far better able to evaluate the many sides of a business and to nurture its development. And the best managers, especially for long term investment or family money, are integral thinkers that balance risk and opportunity to build long term value.

Real Life Results

The legendary VC investors that launched institutional venture capital in the 20th century must have exhibited full spectrum character. They were angel investors who also applied professional method and standards to their investments. They had the passion of the angel investor combined with the diligence of seasoned business people. People like Arthur Rock, Thomas Perkins and Ben Rosen are examples.

Compaq Computer provides an illustration of a venture capitalist successfully combining the spectrum of talents from personal care and diligence to stakeholder care and fairness of operations to build a successful venture.

Compaq Computer Corporation was founded in February 1982 by Rod Canion, Jim Harris and Bill Murto, three senior managers who left Texas Instruments and invested $1,000 each to form their own company. Sketched on a paper place mat in a Houston pie shop, the first product was a portable personal computer able to run all of the software being developed then for the IBM PC. The founders presented their idea to Ben

Rosen, president of Sevin-Rosen Partners, a high-tech venture capital firm. The venture capitalists were impressed with the idea of a portable product innovating within the emerging standard and agreed to fund the new company. However, Rosen realised that the team did not have the some of the personal and impersonal characteristics, like sales urge and discipline, required[xiii]. He shut them up in rented space for three months to write the business plan from scratch! Ben Rosen continued as chairman of Compaq's board of directors until September 2000, nearly 20 years, when Compaq CEO Michael Capellas was elected chairman of the board by unanimous vote[xiv].

Here are two other case studies[xv] taken from our own experience which illustrate the spectrum of “Red Braces” to “No Tie”. Our first case study is “Red Braces”. In late 2002 an emerging database software company serving Europe and North America, let's call it “DataSoft”, which had weathered the dotcom crash, hired a new CEO to raise VC and sales. Some thought that it could unnerve the big players Oracle and IBM its software was so revolutionary. Unfortunately, the recruited candidate, though looking good because of his recent role as CEO of a company that made a successful NASDAQ listing, was very egocentric in his character. With a lucrative package, including golden parachute, he immediately began building fiefdoms in the business of less than 50 employees. Venture capitalists were quickly turned off by arrogance and greed. Sales were difficult to close because sales incentives were changed repeatedly. And then the technology team, whose core had built Yahoo, started to become dissatisfied with the lack of communication and poor work-flow management. Within 2 years the company was in administration, shareholders had lost most of their value, and the CEO continued to bleed the company of assets for his personal account. There were some points early in this story when the tragedy could have been averted, but inexperience among the remaining executive team and an inflexible contract with the CEO made that difficult. Today the technology is ring fenced and the company is a zombie, occasionally doing sub-contract work for the sales and technology managers who left to go to other businesses.

Our second case study (“No Tie”) is of an Auto Parts manufacturer in Asia, lets call it “AutoPart”. In this story it is the venture capital company that missed a golden opportunity because they were overly rigorous in their requirements. The business was a leading supplier of parts to assemblers like Ford. It had managed to weather a severe downturn in its related auto sales and leasing business catalysed by the Asian financial crisis. Review of the business on the ground revealed a manager who could work with a funding board of directors, and introduce kaizen operations in a traditional work environment. The most visible sign of this success was the low staff turnover and the practice of staff returning for the open working environment and company care, although cash salaries were not top of the market. Recommendation was made to invest by the team on the ground, however review by the offshore investment committee hit a stumbling block – the representative of a bank investor who was unfamiliar with Asian business could not get comfortable with the style of the management and no investment was made. Within 12 months alternative financing was obtained by AutoPart, and the business listed five years later to become a darling of the stock market..

The Crunch

Venture capital is where the rubber hits the road in the finance world. The venture capitalist can easily reduce flexibility and shorten the life of a business if they apply dogmatic hygiene in their relationships. If they treat the business as a transaction, long term value will be lost. If the venture capitalist can demonstrate systems and culture that nurture value across the organisation, then they are truly adding value – both capital and quality.

Prepared by Astraea.net. Written by T. Butler. Edited by P. Butler.
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i Business life cycle and funding cycle chart from 1000ventures.com http://www.1000ventures.com/venture_financing/vfin_main.html

ii GRI Equity benchmark for VC based on long term VC returns in Europe and USA. www.griequity.com

iii Business stage and Risk chart from GRI Equity based on experience of capital requirements, benchmark financial asset returns and risk profile.

iv Adapted from family firm table by John Ward, IMD - http://www.griequity.com/backup/BusinessGuides/entrepreneur/familyfirmtable.html

v http://en.wikipedia.org/wiki/Kaizen

vi http://www.griequity.com/admin/sophisticated/vcapproach.html

vii Especially see Don Beck, Richard Barrett, Ken Wilbur. Overview here: http://www.astraea.net/holonics/holonics/holonics.html

viii Also see The Tao of Physics, Frijtof Capra 1974 ...

ix http://www.lifeworktransitions.com/exercises/part1/mazlow.html

x Adapted from sources including Don Beck, Richard Barrett, Ken Wilbur and various chakra references. http://www.astraea.net/holonics/holonics/holonics.html (200412) Full table here: http://www.astraea.net/holonics/holonics/astraeaspiral.html.

xi The full sequence of colours is most commonly cited as red, orange, yellow, green, blue, indigo, and violet, though this is an inconsistent list; all primary and secondary colours are present in some form, but only one tertiary. It is commonly thought that indigo was included due to the different religious connotations of the numbers six and seven at the time of Isaac Newton's work on light, despite its lack of scientific significance.

xii Adapted from Richard Barret presentation SiB October 2004 – www.valuescentre.com

xiii Chris Golis 1997 discussion

xiv http://h18020.www1.hp.com/corporate/history.html

xv GRI Equity client case studies. T. Butler. www.griequity.com