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FOR INVESTORS, FOUNDERS ARE SHORT-TERM CEOs by Jeff Bailey
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Is running the company your founded and then, after five years, being fired by your investors a sign of failure? Or is it a sign that for half a decade you succeeded?

Many entrepreneurs, of course, view being booted from the company they started as the ultimate indignity, akin to losing a child-custody battle.

A Sept. 30 Enterprise column on that topic, with some once-axed founder-entrepreneurs swearing off venture-capital backing in their new start-ups to avoid losing control, had some venture investors crying foul.

"Think," wrote Gerald H. Langeler, a partner at OVP Venture Partners, a West Coast firm that has about $500 million under management and has helped finance some 75 start-ups, "how awful it is to back an entrepreneur who turns out not to have the CEO ability we hoped. The founders may lose control, but we may lose millions of dollars."

Power or Wealth?

Thus, Mr. Langeler, a former start-up entrepreneur himself, asks founders seeking venture money: "Do you want to be the boss, or do you want to be rich?" Being both is possible, he says, but "if push comes to shove, we want the shared goal of financial success to trump any personal goal for management control."

Post-bubble entrepreneurs can expect their management credentials to be viewed more skeptically by venture investors and can anticipate being yanked from the CEO's chair sooner, rather than later, should trouble arise.

In the late 1980s, OVP was an initial backer of Verity Inc., a Sunnyvale, Calif., software firm that today has a market capitalization of about $600 million. Along the way, the investors asked two CEOs to step aside.

But Chad Waite, the OVP partner who still serves on Verity's board, says he views both of those early CEOs as successes, not failures.

The first one, a founder, propelled the company past $10 million in sales. When it was time to shift revenue from government contracts to commercial sales of software, however, the company lagged behind expectations, and it was time for the CEO to go, Mr. Waite says.

The second chief made the transition to commercial sales successfully, took the company public, but then stalled in helping Verity become a more mature, disciplined operation, Mr. Waite says. Exit No. 2. Neither of the CEOs could be reached for comment.

Management turmoil? Hardly, says Mr. Waite. We all see Bill Gates and Michael Dell on magazine covers, founders who run huge and ever-changing companies. But they are unusual.

It's abnormal to have the guy from Day One who has the capacity to grow and morph," Mr. Waite says, calling Verity's four CEOs in about 15 years fairly normal.

Indeed, Dick Strayer, a Los Gatos, Calif., consultant and clinical psychologist who advises investors and start-up CEOs on management issues, says that in the 200 or so companies he has advised, fewer than 40% of founder-CEOs made it past the second round of venture financing.

Closing the Gap

Mr. Strayer, who sometimes advises OVP and companies in which it invests, says his job is to help a founder-CEO view separately the job and the investment in the start-up. And he also performs what he calls a gap analysis, evaluating the founder's management skills and experience and comparing that with what's needed to make the company a success. Some can close the gap. Many can't.

What helps a founder – often the person who developed a new technology application, which can be solitary work – succeed as a CEO? Leadership. Was the founder a captain of a sports team in school? Mr. Strayer asks. Ability to resolve conflicts. Did the founder's family discuss issues and deal with disagreements, or just keep such matters bottled up?

Not all messed-up companies have messed-up CEOs, Mr. Strayer says. And quite frequently, when trouble hits and venture investors call for the CEO's head, Mr. Strayer as adviser sticks up for the founder-CEO.

Generally, however, says Mr. Langeler, the OVP partner, he believes venture firms, including his own, err on the side of waiting too long to yank a CEO.

Only Optimists

"Venture capitalists have to be optimists," he says, since they're investing in firms that often don't yet have a commercial product or any revenue. Founders, betting all their time on a start-up, are optimists, too. "And when you get a bunch of optimists in the room, it takes a while for reality to set in."

It usually takes about six to 12 months to realize a CEO isn't up to snuff, Mr. Langeler says. "Perception lags reality."

Gary Sbona, CEO of a management company, Regent Pacific Management Corp., San Francisco, that hires on to help underperforming or troubled companies, was Verity's third chief. And he wasn't fired, instead recruiting and helping to train his successor, Anthony J. Bettencourt.

Las week, Mr. Sbona watched the Chicago Cubs and Boston Red Sox blow seventh-game leads, ending their seasons by leaving starting pitchers in too long. "It's no different in business," he says. Some venture investors "wait until the freaking building is practically burned to the ground before they call us in. They wait too damn long."