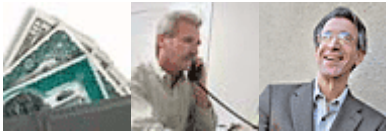


Hired, no paycheck

Entrepreneur trades in employees who work for startup equity

- Ilana DeBare, Chronicle Staff Writer

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Reynaldo Gill and Ken Crittendon, founders of a Fremont startup called Commendo Software, were in a common catch-22. They hoped to get venture capital funding. To attract that funding, they needed a team of experienced sales and finance executives. But since they didn't yet have funding, they had no money to hire those people.

Many startups founder at precisely that impasse. But Gill and Crittendon found an unusual solution. They contacted a small San Francisco search firm called PeopleConnect that specializes in placing executives and tech professionals who are willing to work without pay until VC funding comes through. The firm found them a vice president of sales and director of finance who agreed to work for equity. PeopleConnect and its CEO, Max Shapiro, have carved out a small but unique niche in the recruiting world with what they call their "Employees Without Paychecks" program.

Even more notably, Shapiro developed this program as a response to the dot-com bust -- taking what could have been a lethal business slump and instead using it to create a new business model.

"I have not heard of this in my 25 to 30 years in this industry," said Robert Zahra, chairman of the National Association of Executive Recruiters. "It sounds like they are on the cutting edge."

'Angel employees'

The basic concept of tech executives working for equity isn't new. For years, founders of startups have compensated themselves and a few key employees with stock options instead of cash. Recruiters have occasionally placed executives in such situations and taken their own payment in the form of stock.

But PeopleConnect is the first search firm to market a program of recruiting employees who will work for equity. "A friend of mine calls them 'angel employees,' " Shapiro said, comparing them to angel investors, who fund early-stage companies.

The concept has its roots in the collapse of the Internet bubble. A serial entrepreneur with an eclectic background, Shapiro ran baseball fantasy camps and started a high-profile business buying and selling used Levi's before launching PeopleConnect in 2000 at the height of the dot-com boom.

The company thrived for a year. Then the bubble burst, VC investment and tech hiring ground to a virtual halt, and PeopleConnect found itself struggling to survive.

Many recruiters left the field. But Shapiro saw an opportunity: matchmaking for companies that needed employees but didn't have cash, and unemployed tech veterans who wanted to work and didn't need a paycheck right away.

"I saw early-stage companies presenting (to investors), and a lot of the time being told, 'If you had more people on your team, we'd invest,' " Shapiro said. "Meanwhile, there were people out there who loved the startup craze and would rather be employee No. 6 than 60. They're not necessarily wealthy people, but people with some money saved up or a working spouse."

Over the past three years, PeopleConnect has placed about 50 people willing to work for equity rather than pay. It also continues to provide conventional recruiting services.

Shapiro markets the Employees Without Paychecks program to early-stage companies that, like Commendo Software, are just a few months away from seeking venture funding. He selects client companies carefully to avoid placing candidates at ventures that have no chance of success.

Candidates are initially treated as independent contractors and paid with stock options, with an understanding that they will become salaried employees when the company gets VC funding.

Contingency fee of 25%

PeopleConnect charges a contingency fee of 25 percent of the candidate's first-year earnings. It takes a small portion of that fee in a combination of cash and stock options right after the candidate starts. But most of the fee is due when the candidate goes on salary. If the client company never obtains the resources to hire the person, PeopleConnect doesn't get paid.

"In a way, we're investing in the companies as well and hoping they get funding," Shapiro said.

While applauding Shapiro's creativity, some observers question how well the Employees Without Paychecks model will work as the tech economy continues to recover.

"It was a brilliant idea after the dot-bomb," said Bruce Maxwell, a Los Gatos consultant who advises startups. "But as the economy picks up and there are more conventional jobs available, the supply (of employees) that Max brokers will tend to go away."

Startups that have hired staff through PeopleConnect say the program has been a great success. For some, it's not just a question of cash flow but of finding employees with an entrepreneurial, boot-strapping bent.

"Deferring the salary wasn't our No. 1 priority, but in hindsight, it was an excellent idea," said Jonathan Hubbard, CEO of a San Francisco firm called LandSonar that used PeopleConnect to hire an engineer.

"The kind of people who are attracted to Max's idea are appropriate to the phase of company we have. We wanted someone who was not a 9-to-5er and who would be comfortable with the lack of infrastructure at a startup. ... This was a great way of finding the right kind of people."

Employees who have found jobs through the program also praise it, while acknowledging that it requires a strong stomach for risk.

Some take the plunge because they have been unemployed for too long and are hungry to get back in the work world. Others do it for the opportunity to own part of a startup, gambling that the financial rewards down the line will make the sacrifice worthwhile.

"Working without getting a paycheck is not the most opportune thing, but hopefully, in the long run, it is more worth it," said Jeff McCartney, who was recruited by Shapiro to be CFO of an Irvine firm called Stream Theory.

"I've been working for over 25 years in big companies like Pitney Bowes and smaller companies. I wanted to be part of something from the ground up. The opportunity of being the right-hand man, helping grow and develop the business, doesn't come along every day."

At Commendo Software, Erik Hoogerhuis was recruited in February to be vice president of North American sales. He thought long and hard about the offer, since he is supporting two children at college and a teenager at home.

"Frankly, the idea of working without pay didn't thrill me," Hoogerhuis said. "Absolutely, it's frightening. When you're young and single, it's easy to control your spending. But when you have teenagers at home, you can't tell them 'You're going to live like people with no money.' "

Career hiatus

Hoogerhuis had sold systems for companies like IBM and Oracle in the past but had been unemployed for 11 months. He decided that Commendo was worth the risk.

"I liked the technology, and I liked the approach and attitude of the two founders," he said. "And although you can bemoan the fact that you don't have a paycheck, they're in the same situation. Everybody is working for sweat equity."

Commendo is seeking a \$5 million round of VC funding. If and when they receive it, Hoogerhuis will go on salary. So will Lynn Kraus, the finance director recruited by PeopleConnect.

Commendo's founders hope that their presence will make that funding a little more likely.

"By bringing these people on, we were able to raise the credibility and value of the company before going for our next investment round," said Crittendon, the company's CFO.

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