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Connie Loizos

Talking with Silicon Valley's Favorite Psychologist, Dick Strayer

Posted on: December 10th, 2008 Dick Strayer Strayer Consulting

Dick Strayer, a Los Gatos, Calif., psychologist, has been helping venture capital firms and their startups sort out their emotional and structural kinks for the last 26 years.
Strayer's expertise doesn't come cheap. Businesses pay his consulting firm between $50,000 and $75,000 for what is typically a four-month-long engagement, wherein teams are assessed, strategies are reevaluated, and, often, certain performers are "transitioned" out the door. Despite the expense, business is booming these days — to Strayer's own astonishment. He's working with 20 venture firms right now, and nine of those clients have signed on since September. "The only upside of this economic debacle has been a rush of venture groups that are contacting us," he says. "It's shocking." Strayer and I chatted this morning about what he's seeing — and that's plenty, from finger pointing to consolidation talks. Here's the first part of that conversation. This is the 2nd installment of the interview.

2nd installment

In this installment, Strayer talks about the "one fund lag" in bringing aboard the right people, the reemergence of "operating partners" who are paid consulting fees, and what percentage of venture firms are talking about banding together to survive the next two years.

We've talked about two types of venture capital firms that are calling for your help. What's the third?

The third category are funds that are '06, '07 funds that have half their fund remaining and are trying to figure out how to maximize returns -- those are actually the toughest, because they're right now trying to figure out how both maximize their capital and bring in new people or elevate younger members who are experts in the right sectors. There's economic pressure to strategically realign.

But how can a firm that convinced LPs to fund it last year or in 2006 already need a dramatic makeover?

Well, the reality is that because [firms try to market the same teams, to present LPs a picture of stability], there's a one fund lag in bringing in the right people. For example, clean tech, digital media -- they weren't on the radar screen in a meaningful way in late '90s and early 2000.

We talked about the "sage" of the firm getting whisked out the door right now; what other trends are you seeing?

Operating partners, whose real expertise is operational. Many investors' historic expertise is operational but over time it becomes more strategic or financially oriented, so as a company matures and has to go through downsizing and consolidation, VCs often aren't the best investors to be on boards. An operating partner who maybe takes the seats of six or eight boards that need a lot of work -- boards of companies that need to be sold or evaluated and shut down -- is very helpful because that's the lowest interest profit

generator for a successful venture investor. The VC should be working with companies that have highest, not the lowest, potential. So these guys are replacing VCs.

How are they compensated?

In a variety of ways, but one common way, so their pay doesn't come out of partnership funds per se, is that they get a consulting fee that's relatively small, then they get paid in cash and equity by each of the portfolio companies with which they're working, so there's an incentive component. If they sell the company or turn the company around and reposition it, they benefit in the upside.

The idea has been around for the while. There were half a dozen firms doing it in the late '90s, but it began to come around again late last year, and I'm a big proponent of operating partners. It's a matter of math.

We've also talked a lot about belt-tightening. Are GPs being recruited into firms for any less salary than they're historically received?

I haven't seen that, but what is clearly a trend is compensation structure being assigned more of a rationale. In the venture world, there are typically gradations of not just venture partner to partner to GP but within the GP structure there's a three-or- four-step hierarchy, and you move through that in some informal way based on input from the most senior investors, but exactly what are the requirements to move up the chain are seldom defined.

I'm working with four firms right now where one of the thrusts is what are performance criteria to evaluate whether a person stays at the firm and whether they are promoted to the next level in the next fund. We need to have clearer definition rather than an old boy network.

Is it challenging to evaluate someone in this environment, given the dearth of exits?

Well, the evaluation has to be based in part on ROI, but because ROI is a lagging indicator, there are other pieces, too, like the syndicates you're able to work with and the quality of your proprietary deal flow and how well you perform on boards and how many of your companies are seeing up rounds.

But instituting clearer criteria also frees up more funds to let people go rather than having them linger through the end of the fund, or through another fund.

According to recruiter Jon Holman, most people don't advance within firms nowadays anyway, though. Firms recruit GPs from outside.

It's very true that the idea of let's get a young person, an MBA from Stanford or a McKinsey consultant, and move them up to venture partner, isn't actively pursued by many people. It takes too long, and growing your own tends to mean individuals are very insular and that they haven't necessarily developed the skills to help companies but rather the skills to work within that particular venture group,

What I'm referring to is bringing people in as partners and not general partners. Then, they serve maybe two years before moving onto the GP track.

Last question, we touched on consolidation in the industry earlier. Is that a hypothetical at this point? What are you seeing?

I don't think this downturn is a great debacle for the whole category but it is going to be a painful experience for a lot of people. As for consolidation, yes. The discussions haven't hit the media yet, but what other alternative do you have? Either you drop out and do something else, or you think about who you can partner with where some of your people will have a good home and who will give you a better chance of coming out of this in two years. I know of at least four or five firms having these discussions right now. I'd say 15 percent of the industry is saying: how do we figure out way out of this?