Crowdfunding: What Does it Mean to You?
with John Bondaruk

Date: September 19th, 2013

C. Austin Fitts: Okay, John and I are back for another discussion of crowdfunding on *The Solari Report*. John, welcome.

John Bondaruk: Hi, Catherine.

C. Austin Fitts: It's good to have you. We're going to be talking about entrepreneurs. What does crowdfunding mean for entrepreneurs for investors and for all of us? We've been at the big picture level, discussing the general economic trends and also the political agenda. That's important because whether you're an entrepreneur or an investor or someone simply watching this phenomenon, it's extremely important to me that you be able to see the general dynamic and flows, the general economics and politics because this is going to be like a wave. I want to make sure you surf it as opposed to get caught by the wave and drowned in the wave. So it's very important you see the game, and I encourage you to listen to that.

Let's start with entrepreneurs, and first let me describe some of the resources we've created for you to help you approach this topic. At the blog for this *Solari Report*, you'll find a wealth of links and recommended readings, which we think will help. One of the ones we've prepared for you is I've asked attorney Carolyn Betts, who's very knowledgeable about U.S. securities laws as they apply to all kinds of business, but including start-up and small business, I've asked Carolyn to prepare an article called "Legal Pathways for Entrepreneurs to Raise Capital Using Securities: Does Crowdfunding Ease the Way?"

Currently all issuance of securities theoretically is subject to registration with the SEC. Within that process there are exempted pathways. Ways of raising capital where it is not necessary to do a full-blown registration statement with the Securities and Exchange Commission.

I asked Carolyn to prepare an article that outlines and provides links to help you understand what those five pathways are. Crowdfunding is going to create, in theory, a sixth pathway. We need to see what the regulations say when they're promulgated. What's important to you, as an entrepreneur is that if you're going to issue securities you need to find the pathway, which is best for you.

Before you automatically assume the crowdfunding is going to be the best pathway, I encourage you to take a look at that article and make sure you understand the different pathways. As you'll see when you read it, you will discover that this is a complex topic. So I encourage you. If anything, I'm hoping that that article makes it easier for your attorney. Certainly one of the pathways is the state pathway, and it's extremely important that you see an attorney who is knowledgeable about and licensed to practice in the state in which you have a jurisdiction.

So with that, let me describe some of the others – we put up links to some of the other

Solari Reports that I think will be very helpful to an entrepreneur in this situation. One is we did an interview with Peter Ireland, who's got a wonderful guide called the "Startup Guide." It really helps entrepreneurs understand how to start and build a company with a minimal amount of capital. I'm always saying to people, "What you need to start a company is profit, not capital." Peter's very inventive at helping entrepreneurs figure out how they can do things. One of the popular techniques with crowdfunding, which I think is terrific, of course, is selling pre-orders. So we've now seen lots of authors on Amazon selling pre-orders and raising money through pre-orders. If you look at the donation crowdfunding, you see many gifts given, and they're essentially giving you one of something that they're making, or giving you several of something that they're making.

We just finished doing a term sheet for an entrepreneur who's starting a food shop. We structured it – they're selling both loans and equity. We structured the equity as non-voting shares as very important to bring in capital in a way that you can't lose control of the company as a result of disagreements with your shareholders.

One was selling non-voting shares, but the other was selling loans that were convertible into food credits. We've put that term sheet up as part of the resources to this *Solari Report*, and I think that's a really good example of combining this idea of raising capital with essentially selling pre-orders.

We also have an audio seminar, which I did many years ago with Franklin Sanders called *Building Real Wealth*, which I think is a wonderful discussion of the issues of how you really create a business and grow a business. It's very useful to anybody contemplating starting their own business or running their own business.

We have another *Solari Report* called "Family Wealth" with Jay Hughes, and it's a discussion of how families can get together and build wealth. A lot of the crowdfunding process, I think, is going to draw on family resources. So I encourage you to do that.

Last but not least, we have a *Solari Report* – it's how to set up a legal and capital structure for your company. It walks you through the issues, whether you're going by crowdfunding or any of the other five pathways, what are the issues that come up in designing the legal and capital structure for your company, and how do you think through what that looks like? All of those would be very helpful. Any comments?

John Bondaruk: No.

C. Austin Fitts: No, okay. The first thing that I want to stress to any entrepreneur who's contemplating doing a crowdfunding is that this is not only a legal pathway to raise capital, but it's a different way of building the human ecology for your company. So I want to focus on the word crowd. We're talking about creating a field where your customers, your vendors, the other people involved in your network or in your life, in addition to the roles they play, they also become an owner. They also become a shareholder.

There is tremendous power in this where it works, because you're talking about creating an alignment between, for example, your customers and your capital structure. So let me give you an example. If I go down to a big-box store and I spend $10,000 a year on products sand services, and they make a profit of, say, $2,000, and their stock is traded at a multiple of 10 times earnings, that means their stock goes up $20,000 a year. Now, how much of that do I get? None.

But if I'm in either a pool of small businesses or an investor in a small business, the more money I spend at that store, the more the value of my stock goes up. So in essence – it's what we call skin in the game – I get a piece of the action.

I have re-jiggered my alignment between my customer and me because now my customer isn't just trying to get the best deal on this purchase. They want me to make money. They want me to succeed. Now we have created the conditions for a very powerful communications incentive between them and me. So imagine a world where all your customers, because they're shareholders, are running around the world and seeing opportunities and bringing them to you. At times, this can feel very critical to have that much feedback.

But they have a vested interest in making sure your business is growing and thriving and working. What you're talking about doing is creating a crowd intelligence, which is deeply invested in your success.

Now, that can be good when they're calling you on Saturday night and saying, "Hey, did you know your competitor is doing this?" That can also be overwhelming. But it's a much more intense way of going about it, and it's a much richer way. It can be incredibly useful, because one of the greatest mistakes entrepreneurs make is – and I shouldn't say "they," I should say, "we" – we have an idea, and we don't see the things we don't see. We don't know what we don't know, and we need massive market feedback to really teach us that. The faster we get that feedback, the less capital we spend not getting that feedback, if you know what I mean.

There's a tremendous value to this kind of intense community way of doing things. I also believe that if you look at the fundamental economics of what's driving this, there are going to be tremendous advantages of aggregating in various ways, both by place and by community. So within a community, you're going to have ways of aggregating and going through what are called portals. A portal is a website which is specifically created to help entrepreneurs crowdfund. It's registered with the appropriate regulators and is really expert in dealing with all the different legal issues. A portal may focus on a community or it may focus on a network or it may focus on a particular kind of size of opportunity. We already have, I think, about 400 to 500 regulations existing. Once the regulations pass, my guess is it's going to increase dramatically.

So you're going to have portals that specify in various kinds of aggregations or groupings, and that's going to be the basis for lots of support and help and expertise for different kinds of entrepreneurs. So until the regulations are available, we don't have a lot of knowledge. This could go in many different ways.

If I could say one last thing, I was talking to an entrepreneur last week who was a little bit blasé about the legal and financial particulars. I said to them, "Look, if you were building a building, you wouldn't say, 'Oh, you know, safety codes and standards for electricity and plumbing are stupid. I don't need to be bothered to pay any attention to them.' I would say, 'No, you need to pay enormous attention. Those standards reflect best practices of years of learning of what causes fires and what can burn a building down.'" Because legal and financial designs are sometimes relatively invisible – you can't walk up and kick them – we tend to not take them seriously. Particularly in the early days of crowdfunding, because there's so much concern about the changes, I think my concern is that entrepreneurs don't take the time to sit down and design that legal and capital structure with care and then make sure it fits within all the laws and regulations of whatever jurisdictions they're operating under.

If I could say anything, I would say, "Take the time to get that design right, and take the time to find an attorney and make sure you are operating within the law." I would say, "Take the time to find the right portal." So this is all about whom you know: the right portal, the right attorney, and most importantly, the right crowd. Any comments, John?

John Bondaruk: No, that about covers it.

C. Austin Fitts: Okay. This is looking at it more from your and my point of view – investors, my chief message that I want to get to every investor is my expectation that is over the next year to three years, the crowdfunding volume is going to grow. Anybody who's known to be an investor, I think, is going to get overwhelmed by proposals.

Now, if everything goes through portals, then that's going to organize the flow a little bit more. If things really move outside the portals, particularly the encouragement to come into the portal and look, I literally think with your pad, your smartphone, your desktop computer, you're going to see investors overwhelmed with proposals. Those proposals are going to come through the Internet, and they're going to be very attractive. A lot of them are going to pull on your heartstrings.

A couple of things I would say to investors – one is don't be alone in this. If you can – many investors doing private equity organized into angel networks. Angel networks are very powerful because you have people with knowledge about investments who help each other vet and do due diligence. For those of you who have never been in an angel network, you can jump on TV and watch *Shark Tank*. It gives you a little idea of what, I would say, a more predatory angel network might function like.

But I would say don't be alone – whether you have an angel network, or we promote something called Solari Circles. You really want a disciplined process of reviewing and vetting these kinds of proposals. That's number one.

Number two, if you haven't listened to *The Solari Report* we did on entrainment and supplemental programming with Adam Trombly, I really encourage you to listen to this, because I think there's going to be a segment of this world which is encouraged with those kind of fraudulent techniques. When you combine something that really looks like attractive, cool, neatsy-keen entrepreneurs or technology and it comes with that kind of technique, you can get talked into a lot of stuff.

So I think have a disciplined process. Have a group of people who help you stay disciplined. Please understand that that kind of technology exists, and you need to make sure your knowledge of that and you protect yourself from it.

I always say to investors who are interested in doing private equity or small business, "You can only afford to invest that which you're prepared to lose 100 percent." I can see your faces. John knows this well. Now, that doesn't mean don't do it. It's just saying, generally, I find, unless you're talking about mature businesses that has a proven track record, and a proven track record not only of performing on their business but performing for investors. So they have that proven record of making money for investors and respecting the needs of their investors. I would say there are a couple of situations where this is, in many respects, a more enlightened kind of philanthropy than philanthropy.

One is there are going to be people in your family who are starting a business. This gets back to building family wealth. I encourage you again to listen to *The Solari Report* with Jay Hughes. But we've seen over many generations that families that pool their capital and help each other start and build businesses are the basis of not only building wealth, but also building community wealth.

There is a tremendous opportunity for families to organize capital and help each other make their dreams come true. Over long periods of time, that's what builds the economic muscle of a company, and that's what builds great enterprises. There's a real opportunity here to build family wealth. You do that for strategic reasons. It's not just about making the fastest return on investment, because you're trying to build a successful family and a family with successful economic muscle.

The second is strategic issues in your community. I am always saying to everyone who will listen, "If we want to have a fresh food supply that we know is safe, we're going to have to finance it." There is no way that we can look to the corporate system for fresh food and be confident that it's safe. The system is completely broke. If you look at the pressures on a corporate executive at this point, it is literally impossible for them to protect us from GMO food.

Now, if we want that capacity, we're going to have to finance it. We see growing and processing and distributing fresh food is one of those businesses that really can't be done 2,000 miles away. You really can't outsource that to Vietnam. It's got to be done nearby. So to me, there's some tremendous fundamental economics behind backing those businesses.

Now, you can back those businesses, again, with crowdfunding with donations. You can back them with pre-orders. As I said, we just did a term sheet. It's up on the blog of a food shop and processor that is raising money with non-voting shares and loans which convert at the option of the company into store credits. So Slow Money has a website, credibles.org. Take a look. It's for food businesses that are financing themselves with pre-orders. But food is one.

Another is the general businesses in your economic area. I can't tell you how many people I know who have prepared to live through hard economic times, and they've gotten off the grid and they have a one-year food supply and they have all sorts of resources outside the banking system in case anything goes wrong. After doing all this fantastic preparation, what they realize is, "I have thousands of neighbors who haven't done that preparation. What's going to happen? If we really come into hard economic times, what do we do?" That's when they realize, we all have a vested interest in our community being successful economically and the other families being successful economically.

One of the things we're going to see is a lot more coming together in circles or little groups, entrepreneurs together, saying, "Okay, how can we start to facilitate investment to rebuild the economic health of this place?" I have everyone across the country say, "Well, we have no money." That's a little bit of a myth, because if you look at the money in any community – I live in a very poor community – if you look at the money going for illegal narcotics that are for something other than legitimate pain management competing with the pharmaceuticals and you look at what we're spending on the lottery, that is literally enough money to rebuild the whole economy. So if we just shifted over our unnecessary drug purse, if we stop getting high, and we stop playing the Lotto, we would have enough money to rebuild the entire economy, because micro venture does not take a lot of equity.

Of course, it also means we have to cut our TV time and use that time to build skills. But given the opportunities in the marketplace, I think, with this new technology, it's there to be done, and we do have the capital. But it means we're going to have to shift time and money out of non-productive activities and shift them back into productive activities.

A couple of advice for both entrepreneurs and investors on the dark side of life – one of my biggest concerns about crowdfunding is we're going to encourage thousands of businesses to start up, to grow, to grow bigger, to take on new technology, to prototype a lot of new technology that you and I talked about in our first conversation. We're going to do it on a platform where the NSA is listening.

Imagine you're a small entrepreneur. You've got this new technology. You've figured something out. You're ready to start filing your patents. Of course, everybody is listening. You show up at the patent office, and somebody else has stolen it and gotten there first. Or you've build your business to a very successful level and you're ready to sell out to a big company that is represented by a big investment bank. They're listening on the phone, and so they know what price you're going to take and they figure out how to jaw you down. Or one of the movies we've recommended on *The Solari Reports* is called *Startup.com*. It's the story of entrepreneurs who got hit by a covert op. Their stock value dropped, and they got picked up for a song. So those are examples.

I once had someone whose brother became a consultant to do mergers and acquisitions in New York. They worked with the big investment banks to help them pick up small companies. Their job was to get hired by the small company, get the inside information, and give it to the investment banks so they could pick them up cheap. So you have this whole world of dirty tricks that are significantly more dangerous, because we now have a telecommunications infrastructure where they are listening.

So let me just run through – the three movies I would suggest you watch is *The Listening*, which has been on "Let's Go to the Movies" on *The Solari Report* that gives you a sense of how invasive this technology is. A second one is *Antitrust* – another great example, and an example where you're talking about very economically powerful technology. Then finally *Startup.com*. So I would really encourage you to go out and think about, "Okay, how am I going to do this in an operation where I don't have the kind of privacy? I'm dealing with predatory parties who are very invasive. I don't have the kind of privacy. How do I make sure that my intellectual capital is protected and not harvested?" That's one of my chief concerns, as you know, about this process.

Now, some businesses, they don't care. I had one great entrepreneur say to me, "Look, there's no way they can track more than 20,000 situations. It would take enormous manpower." Wrong. They have computers. They have artificial intelligence. They've been working on this stuff for decades. So the ability for them to draw out, through computers and artificial intelligence, the most juicy piece of your conversation and use that, whether to trade you and your inventions and your patents or to use that information to trade a variety of things. I can't tell you how many people I know who get laid off, get home, and within 24 hours, they've got offers from the big banks for 30 percent interest rate credit cards. Or they talk on the telephone, "I have a headache. I have a headache." The next thing you know, within 24 hours, they're getting emails offering all sorts of remedies for headaches.

So this system is very economic in terms of its ability to harvest at a micro level and batch it, use it to trade the markets at a macro level. So just be warned and be careful.

Be careful about the hype, and be careful about the techniques on the other side. That's why John and I spent so much time talking about the bigger picture, because we want you to see some of the agendas here. I think, John, of crowdfunding as a window that's going to open. It's going to let a lot of water that's been building behind the dam flow through, and that's a good thing. It's going to help us shift to what I call the planetary debt for equity swap. We're going to switch out of the debt model and much more into equity model. I see that as a very positive.

So the window's opening, and all sorts of people have a variety of agendas. But I think what I would say is for a lot of investors and entrepreneurs, we can use this for our agenda as well.

John Bondaruk: There will be positives and there will be negatives. Obviously you're focusing on the positives, but some of the negatives would be it's going to be hyped, and some people are going to fall for some of the hype.

C. Austin Fitts: Right. There's no doubt about it. So if this looks like the tech bubble, you just have to get out your surfboard and you have to know. So hopefully the entrepreneurs raise their capital before the bubble bursts and the investors sell their stock before the bubbles burst.

Anyway, that's it. Entrepreneurs and investors, there's a lot more to say, but we really need to wait and see what the regulations say. They're expected in the winter. We have a wonderful, very talented attorney, leading position in venture capital, very experienced in venture capital and private equity, who's agreed that they're going to come on, and we're going to talk about crowdfunding, and we're going to have a second *Solari Report* on crowdfunding once the regulations come out. So stay tuned for that *Solari Report*, as soon as the SEC promulgates its regulations. Again, expect it to be in the winter. Some say October; some say December. So let's just see.

But in the meantime, we can all get prepared. We can all get knowledgeable about this, particularly if it's something that we're going to use as an entrepreneur or invest in as an investor. I just want to say a couple of words. If you're a subscriber and you're thinking, "Well, I'm not going to use crowdfunding to raise money, and I'm not planning on investing in private equity, so I'm not interested in these things." Is crowdfunding something that they ought to care about? Is crowdfunding something they ought to know about anyway?

John Bondaruk: Well, because of the way that you're talking about it, it's going to be a part of life, it looks like.

C. Austin Fitts: Right. This is going to have an effect on many things, whether on particular kind of industries, on particular kind of networks, I think it's going to affect communities. It's like a flow of water that percolates up and starts…

John Bondaruk: What concerns me, and I know we covered this in the first *Report*, is that it bears many similarities to the Internet bubble, and a lot of people were burned by that.

C. Austin Fitts: Right. Well, anytime you see an explosion of technology, we see huge bubble up in the stock market. That's what the '20s was. The Roaring '20s was telecommunications and other technology bubbling up. Then we had the Internet bubble. Of course now we've got a similar burst of technology and equity flowing into it. One of the things I want to stress to anyone as to the general impact is I think this is going to tremendously accelerate the exploration and adoption of new technology. So whether it's building out the Digital Heartland, whether it's integrating this kind of technology into our homes, our highways, our everyday life, whether it's reinvigorating manufacturing in the United States, whether it's a company that's doing it or your 10-year-old making his own toys on his new 3D printer, whatever aspect of it it is, it's going to accelerate change in very phenomenal and dramatic ways.

We've had a lot of change, and I think some people are overwhelmed by the change. This is going to accelerate it. If you're expecting things to come back to normal, get ready for the opposite to happen.

The other thing is we have a whole world of people in the legacy systems expecting collapse. Well, get ready for a boom. There is a part of the economy that is going to be absolutely booming. If I could encourage you, get some deck chairs out of the *Titanic* and get over into the boom and start doing something, because there are scenarios here where it isn't going to collapse. It's going to boom. So this thing could go many different ways. As one dear friend of mine says, "We're willing." We're willing for this to work out. Okay, John.

John Bondaruk: Catherine, thanks a lot.

C. Austin Fitts: Thank you. Thank you. Investors, entrepreneurs, and all of us interested in where the world is going, get ready, get ready, get ready. Crowdfunding is coming. Have a great day.