A NEW TOOL FOR RAISING CAPITAL: THE DIRECT PUBLIC OFFERING

One of the biggest hurdles for many new ventures, especially mission-driven ones, is raising capital. Entrepreneurs often get conflicting advice from their various advisors and are encouraged either to find an angel investor or get a traditional bank loan. Enter the Direct Public Offering (DPO), a relatively little-known way to legally raise capital from anyone using public advertising. From brand-new startups as well as companies (and nonprofits) that have been around for decades, any social enterprise that wants to raise at least $200,000 in investment capital, has a compelling story, and has the ability to pay a reasonable return to investors could be a good candidate for a DPO. We spoke with attorney, consultant, and DPO expert Jenny Kassan about this innovative tool.


Jenny Kassan

Can you provide us with an example of a success story of one of your clients who has actually gone through the DPO process?

Jenny Kassan: Real Pickles was started by Dan Rosenberg and his wife, Addie Rose Holland. They were committed to making pickles the old-fashioned way, with a focus on supporting local farmers in western Massachusetts who used best practices and providing them with another source of income. They were starting to have a lot of success, but they wanted to stay at a size that would allow them to really continue to be completely true to their values, such as knowing their farmers and treating them really well.

Another big value for them was to be able to sell their business to their workers so that they could participate in the success of the business, but they had to figure out a way to finance the buyout. They had put in a ton of time and energy and money to grow the business to the level of success that they were having and they needed to be compensated for that, but the workers didn't have the money to be able to pay them for that value. So they did a Direct Public Offering to raise money from the community to finance the buyout and to finance the growth of the company. We helped them put that all together. When it was approved by the state securities regulators, they started to get the word out with events, mass email blasts, social media, and working with supporters, and they were actually able to achieve their goal of raising $500,000 in just two months.

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Why aren't DPOs more common?

JK: That's a really good question. My guess is that a lot of people are really confused about securities law. They don't know what is and is not legal. There's a lot of misinformation out there. Even lawyers who should know better are telling people the wrong information, like "You cannot raise money from unaccredited investors," which is not true. There are lawyers and advisors who are stuck in a certain model, a very cookie-cutter approach that works really well for a tech company but does not work for other businesses, but that's all they know. They can't open their minds to the fact that there are other possibilities.

Also, in some ways the JOBS Act of 2012 created even more confusion because it changed the law, and a lot of hype and misinformation got spread and made people even more convinced that until that new crowdfunding exemption went into effect, it was illegal to raise money from the crowd, which is not true. Whether the JOBS Act had passed or not, it's been legal for decades. That's my guess as to why they're not more prominent. But we're definitely trying to change that.

> "Being able to ask for smaller amounts and going to people who you know really understand what you're all about and support what you do - it just feels way more comfortable, and fun.

What are the top things that you wish people knew about DPOs?

JK: First, there are now legal ways to raise money from the general public, including both accredited and unaccredited investors. The process isn't as easy, usually, as starting a Kickstarter campaign, but it's not that difficult. Don't be intimidated by the process. The government staff in the securities division in each state is there to help people do this type of thing.

Also, understand that if the cookie-cutter approach that's often used in the Silicon Valley-style high tech companies is not working for you, that doesn't mean there's anything wrong with you. It might just not be a good fit for your type of business. Less than one percent of businesses are funded by angels or venture capitalists. If you're going out trying to raise money that way and it's not working for you, that does not mean that you're bad, you're dumb, or your business is crap. It just means you're part of the 99 percent for whom that model doesn't work.

Also, realize that sometimes that model doesn't create great outcomes for the people who do receive that money. Oftentimes they can get fired from their own company or they can be asked to do things they don't want to do. I just wish people could see that it's just one model and it works for some businesses, but there are other models that can be way better - depending on your situation, of course.

What are the challenges associated with the Direct Public Offering? Have you had any client companies that have had a hard time dealing with the fact that all of a sudden they're gaining a lot more stakeholders in the company and a lot more people to deal with?

JK: So far, I've been really surprised at how little of a problem that has been for everyone I've worked with. I had one client that had over 1,000 investors. At Cutting Edge Capital, where I was CEO for five years, we had about 60 investors. Most of my clients have been somewhere in between those two and I haven't heard a single complaint about that. Because the minimum amount that can be invested is low, usually about $1,000, the investors are not putting in more than they know they can afford to lose. They know it's a high-risk investment. They're busy people and they have other things going on in their lives, so they really don't tend to get very involved or want to micromanage everything. I have yet to hear a single issue where an investor has become a thorn in the side of a company. If anything, it's the opposite. We almost had trouble sometimes getting our investors to respond to us.

Obviously, you do have to track all your investors and make sure you have their current addresses and all of that. Another thing is, unlike a loan where you're making a monthly payment, most of our clients were only making an annual payment. So, it's really just once a year that you have to look to make sure you're calculating the payment correctly, have the right address to send the check to, etc. It's not that challenging or demanding at all. If anything, it may be less so than when you bring in one large investor where, because they put in so much money, they want to have control.

Can you explain the difference between a DPO and equity crowdfunding?

JK: I don't love the term "equity crowdfunding" because it implies that when you're raising money, you have to offer equity. There are many different kinds of securities that you can offer when you're raising money. I prefer the term "investment crowdfunding," because you may offer a debt instrument, too. People have gotten really creative with debt instruments, such as setting up royalty payments where the amount you pay depends on how well the company does. I don't want people to feel like they have to offer equity. It's not right for everyone. Some people love to offer equity; some people would rather do debt. A DPO is a way to do investment crowdfunding.

The law that was adopted in 2012 that hasn't come into effect yet under Title III of the JOBS Act offers another tool for investment crowdfunding with a crowdfunding exemption. This will add another tool in the toolbox, but there are already many tools for doing investment crowdfunding and they all have their pros and cons.

There's a disparity with regard to the amount of money that's loaned to women versus to men. I'm curious if there are tools that women should look into to help them remedy that gap?

JK: I was a woman CEO and I raised money for my business and I've tried different ways. I've tried using the DPO model and I've tried taking it to impact investors. Personally - and I wouldn't be surprised if this were true for a lot of women - it's more comfortable for me to be able to go out to a larger population of potential investors instead of having to go to a small group of impact investors. It's hard to even get an appointment with them, and they can be really intimidating. Even impact investors usually are looking for a high-growth business with a potential for an exit at a high multiple. So if that's not what your business really is, it can be really frustrating to talk to those investors because they just don't really see the value in your model.

Being able to go out to a larger community of potential investors - who can include your customers, your friends, your neighbors, your fans - is a much friendlier way to raise capital. I don't like to generalize too much, but I think for a lot of women, we love to be a part of a community, and if we can invite our community to become investors, it feels really good. Again, I hate to generalize, but I know a lot of us women are afraid to ask people to take risks on our business because we know our business is risky, and it's scary to say, "Yeah, put your life savings on the line for my business, which I think is going to succeed, but I don't know for sure." When you can spread that risk among a larger number of people who are putting in an amount that they can afford to lose, it just feels so much more comfortable. You know that no matter what happens, you're not going to ruin anyone's finances. I know for me it felt a lot more comfortable than the other route.

> "It feels like a barn-raising for your business."

Not to say that it was easy, though - you're still having to ask for money and that can be challenging for a lot of us. But being able to ask for smaller amounts and going to people who you know really understand what you're all about and support what you do - it just feels way more comfortable, and fun actually. It was scary at first but the more we did it and the closer we got to reaching our goal, it started to get fun. People started to help us. We would talk to someone at a conference and they would call all of their friends, and they'd say "Do you know Jenny's raising money? Come on, you should go invest!" You can't do that if you're raising money in the more traditional way. It feels like a barn-raising for your business. $