LEND ACADEMY

PODCAST TRANSCRIPTION SESSION NO. 234–MICHELE ROMANOW

Welcome to the Lend Academy Podcast, Episode No. 234, this is your host, Peter Renton, Founder of Lend Academy and Co-Founder of the LendIt Fintech Conference.

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Today's episode is sponsored by LendIt Fintech USA, the world's largest fintech event dedicated to lending and digital banking. It's happening on May 13th and 14th, 2020, at the Javits Center in New York City. Lending and banking are converging and LendIt Fintech immerses you in the most important trends of the day. Meet the people who matter, learn from the experts and get business done. LendIt Fintech, lending and banking connected. Go to lendit.com/usa to register.

Peter Renton: I am delighted to welcome Michele Romanow, she is the President and Co-Founder of Clearbanc. She is also a serial entrepreneur and something of a celebrity north of the border, and we'll talk about that in a little bit. But, Clearbanc is a truly fascinating company, they have got a unique approach to financing growth companies, particularly those companies that are venture-backed, or could be venture-backed. They have a venture alternative that I think is as fascinating, I think it's really groundbreaking.

No one else has really done this before and they're proving that this can work. So, anyway, we talk about their model and we talk about how they're able to analyze data and the kind of data they're able to do without to operate financing without a personal guarantee. We talk about how they find their customers, what happens when things go wrong, and who they view as their competitors and where they find different companies to fund. It was a truly fascinating interview, I hope you enjoy the show.

Welcome to the podcast, Michele!

Michele Romanow: Thank you, it's wonderful to be here.

Peter: Okay, well you have a very interesting background and I'd like to give the listeners some of the details about it. You're somewhat of a celebrity up north of the border, I have heard. So, tell us a little bit about what you've done before you started Clearbanc.

Michele: Yeah, of course. So, I've been an entrepreneur for as long as I can remember. In fact, you know, I finished engineering school and have figured out the worldwide supply of sturgeon caviar of all products to sell and 95% because the world had overfished the Caspian Sea. This is a true story, if you can believe that, and most people I met discovered that I was crazy enough to move to the East Coast with two co-founders and build a fishery from scratch as my very first business.

Peter: Wow!

Michele: Everything it sounds like, so fishermen...my hands knee deep in fish like the whole nine yards and our thesis was right such that we were going to get the products that we had, no problem selling it. The issue was that shortly after we started the business, we went into this giant recession in 2008 and I'm 21 years old, selling the world's most superfluous luxury product. (Peter laughs)

So, it was a great first experience...you know, I think it's just powerful that I could start my career with probably a pretty epic failure, it felt like at that time, but from there, I ended up taking a job at a big retailer as the Director of Strategy. I saw e-commerce blow up and ended up starting an e-commerce company in Canada called Buytopia. We couldn't raise any money, but grew really, really quickly through low cost user acquisition and that became a huge theme in what we're doing today.

We ended up buying kind of our competitors, that whole company would go public in a year, or two, which is a really cool story. But, I burn this point about like how powerful it is to have, you know, low acquisition cost, especially when you bought an e-commerce company. From there, ended up starting another app called SnapSaves that digitized coupons for CPG companies, so our customers were the Coca-Colas and the Procter & Gambles and that company was acquired by Groupon.

And then, after I was there at Groupon, ended up running the board of a few public companies and then the last thing was I joined the cast of the Canadian version of the Shark Tank television series, but since we are talking about, at the beginning and so the ....it's called Dragons' Den in Canada, it's the same format. And, what most people don't know about the show is that we actually see, like almost 250 pitches in 17 days of back-to-back filming.

Peter: Oh, my God.

Michele: So, I mean, even if you're greatly seen, you're not seeing kind of 12 pitches a day, like this is rapid fire and it was from the show.....you know, I was truly rare that you get an incredible idea from reality television, but I was watching all of these entrepreneurs come on the show.

You know, I remember these guys with these wooden iPhone cases and I said, look, you know, we need a hundred grand for 25% of our company, we're going to use all the money to invest in this because, you know, we have great economics. We sell each iPhone case for $50, it cost us $10 to make and $10 in upsend. And, I just kept thinking like this isn't a good deal for either of us, right. You guys really need the capital to grow and so ended up..... you know, just kind of creativity at that time and so I said, look, why don't I give you the $100,000, I'm not going to take 25% of your company.

What I want instead is I want 5% of your revenue and so you pay me back $106,000 so I was going to charge 6% for my capital, it wasn't very expensive, but I would get a return almost immediately, or very, very quickly within my first year and the founders weren't giving up a piece of their company. The only hitch is I want to see your Facebook ad account because I ran an e-commerce store for a number of years and I kind of know what I'm looking for. And so that was kind of..... you know, in a funny way, like the very first Clearbanc deal.

I don't think we ever thought that this would get as big as it has, but I think what has driven that is today, you know, founders when they take on equity capital....you know, almost half of that, 43% of that, goes straight to Google and Facebook. It goes to user acquisition and growth which makes total sense, right, all of us need to grow. Technology has become less of a mode, but, you know, Google and Facebook......the amazing part about all the visual apps platforms is we know when you inject a dollar, you get $4 in sales up. And so, what effectively happened is founders started using the most expensive capital in the world which is equity to do something that by definition should have been repeatable and scalable.

So, that was kind of ....you know our pitch in the market is instead of using your equity dollars which causes you to give up a piece of your company and never get back causes you to lose control is a three to six-month process to go on the road is very difficult to close. You know, we can give you, at least, an alternative offer to fund all your outspend, so this means.....for example, a company....like let's say you're going out to raise a Series A, you're an e-commerce company, you need $10 Million and $5 Million of that will be spent on user acquisition, you know, you should raise $5 Million. Take half the dilution and then take $5 Million from them and that's been kind of how we've been able to see it.

Peter: So then, just walk us through the process a little bit there. Actually, maybe before that, what are the range of investments that you're making and how does it all work, as far as the terms of these deals?

Michele: Yeah. So, we called the product the 20-Minute Term Sheet because we wanted founders to be able to get a 20-Minute Term Sheet which is so unusual compared to the three to six months it usually takes to get a term sheet. So, to do that, you have to give us access to your major data accounts so your payment processing, your bank account, your absent account and your e-commerce account. If you remember your password.....I know that I don't always remember all of mine, but if you remember your password, this process truly takes just 20 minutes.

And then our system is automated on our end where we can say, you know, based on the data that you've given us, this is how much capital that we can give you and we will start companies as small as $10,000 and we have gone up to $10 Million. So, we wanted to be able to serve the founders that are just getting going and also the founders that have really scaled up and maybe we can be a substitute to half of a Series B round, or something like that.

Peter: Right. So, I want to be clear here, this capital comes with no personal guarantees and no assets backing the capital, right, this is ....you are just making this based on the strength of how you see the company and their performance in the online ad space. Is that correct?

Michele: Yeah, that's correct, there is no personal guarantees in our model. You know, I have a story very early in my career, I mean, I've been an entrepreneur my whole life where I didn't know that in....you know, a service that was signing up for, a statement processing actually, that there was a personal guarantee involved in that within five/six months on some terms of service of the agreement, and it turned out to be hugely problematic when we had an issue. So, since that point, I just thought it was incredibly unfair that we ask founders to not only put up everything they have, instead of building their company, but then say, your personal assets are indeed at risk.

And so, that was a huge, huge thing for me that our products would not have personal guarantees attached to them and the way to do that is....yeah, we're taking substantial risk on this company, there's no question. What our thesis was is that we believe that with better access to data, we would be able to mitigate risks with better data. And so one of the things that, you know, the SMB lenders have done is they've looked at personal credit scores for what's indicative and in our mind what we wanted to do was we wanted to automate the VC underwriting process.

So, when you go take your e-commerce company to a venture capitalist they say, well, let's look at what your growth is, what your revenues are, what your financials are, what your cash to LTV ratio, like how much is it really costing you to acquire each customer and can you do that profitably and we use our own series of metrics that are really based on that, to do that which is a lot to be able to give this capital to founders without personal guarantees.

Peter: That is super interesting. I'll tell you, I think as someone....I've tried to raise money before in many ways and then tried to take loans out to businesses and I've never done it without a personal guarantee. That's really groundbreaking, but not only are you able to get....some of these businesses probably are pretty light on assets, I imagine. Some of the founders might be live on assets, but......

Michele: Of course.

Peter: Yeah, that's.....

Michele: And there are different style of businesses, right, like these rev shares were really different than what conventional data was like that is this concept that there is an asset there. So, you know, if I have a beautiful bordered table, someone says, look, I'll give you $5,000 and if you don't pay me back I can take your table, I can take an asset. But, in digital businesses they are not asset heavy, there is no, you know, oven, or equipment and fleet of vehicles and real estate that looks like asset value.

The asset value today is what is your return on some of these ratios, right, and so it was really looking with a fresh set of eyes from the perspective of a founder. If you had been, you know....I mean, this is the first company I've raised any sort of capital for and I just completely appreciated how difficult it was to do so and in many ways, how biased the current system is and I'll give you a couple of examples of that. So, you know, one of the things is that we do all of this work algorithmically, we don't look at individual applications and as a result of that, we don't have anything at the top of the funnel.

We have funded eight times more women than the venture capitalist average, isn't that amazing, I think it’s amazing. And that was our mission, that is the by-product of taking the bias out of decision making which I think is an even more incredible story to tell because there are certainly these good founders that's not being found and VC is a person-to-person business. You have to be in the right network, you have to know......I mean, most VCs don't even take cold e-mail introductions and so it is naturally biased to certain groups of people that you either grew up with, or went to school with.

The other part that's really interesting about this bias piece is that right now, 80% of venture capital dollars get deployed in four states in America, basically that’s California, New York, Massachusetts and there was nine states last year in America that had zero companies that got venture capital dollars. So, the logical conclusion to that could it possibly be that there is no good company for nine states in America? It's that this person-to-person business of venture capital hasn't reached that far.

And so, when we look at our portfolio, it's....you know, I think we've reached 40 states, so far, something like that, 43 states, and we're able to see a huge diversity of great businesses and where the founders might not have grown up in this network of circles and even if they did. I mean, think we've offered a really compelling solution to them.

Peter: So then, are these companies typically like e-commerce companies, or just maybe just tell us.....like they're obviously got....they're selling products online, I imagine, but maybe give us some examples of the types of companies.

Michele: Yeah, great, great question. So, lots of brands you’ve heard of, Lisa, Nectar Sleep and Public Goods with Tote and Tucket and tons of e-commerce companies are our customers, but we'll do anything where you can see that return on ad spend, so we do consumer apps, it's a completely fine category for us. Our vision is that anything that's repeatable in a business that you're funding with equity, we should be able to fund with cheaper capital on a rev share agreement, and so, we look at things like SaaS companies.

If you have a SaaS company and you have a sales force of folks selling your product, you know, they're typically....those commissions have to be paid today, for SaaS products that will be paid over the next 12 to 24 months. It's like why would you use equity dollars to fund that when you could use cheaper capital to do that. And so, we're looking at kind of everything that encompasses that.

Peter: So, it does not have to be spent on Google and Facebook, the money that you're providing. I mean, what sort of guard rails do you put in place?

Michele: Yeah, that's a really good question. So, what we've done is.....I mean, our original product was just ad spend and it's the one that we understand the most so we make our capital the cheapest. So, if you buy in a Facebook, or Google ad, your flat fee is 6% so that means we give you $100,000, we get a percentage of revenue until we get $106,000 back. And then, if it's used on inventory, or anything else, it ranges between 9 and 12%, so, again, still very affordable, but we just understand the ad space the best, but you can use our capital for everything. What we've done is we've also looked to really provide value for the things that our customers are buying the most as an additional advantage for being one of our portfolio companies.

Peter: So, what are the....apart from ad then, what are they...and you gave that SaaS example, what else are they spending the money on?

Michele: Oh, I mean, everything it takes to run a company. So, we have a lot of e-commerce companies that we see a lot of inventory purchases. There's always a balance between, you know, how much to sell versus when to order new stuff, we see lots of shipping within that as well, and then all the other additional costs like running an office and a team.

Peter: Okay. So then, how do you find these companies, I mean, what is the marketing strategy for you guys?

Michele: Yeah. So, I think, it's been a combination of inbound and outbound for us. Certainly, lots of people have found us and then might look, this is a great option and a very likely option for me to try and see what my 20-Minute Term Sheet says. The other thing that we do is, you know, we prospect and look for all of the great e-commerce companies that we want to back and we reach out to them as well and so it's a combination of that. And then, finally, we have a partnerships channel where we work with a ton of different partners across kind of the e-commerce and SMB space that are really helpful for us.

Peter: Okay, so then you've been in business for some time now, for a few years, and you've had, I imagine, many of these loans being fully paid back, or advances, I guess you would call them. How long does it take typically for the average customer to pay this back?

Michele: Yeah, it's usually between eight and 12 months, it's probably our average. So, you know, companies are using them, they're coming back when they need more capital to grow and our mission is to be kind of the easiest, most affordable growth capital as they continue to scale their business.

Peter: Right, okay. And then, what about when things go wrong because, obviously, there are companies that might look great on paper, something happens, and suddenly, they are really struggling. Can you give us ....and you don't have a personal guarantee, or you're not holding security, so what do you do when things go wrong?

Michele: Yeah. When things go wrong, we really try and work with our companies to work out, you know, a solution that works best, but the real answer to this question is, you know, Peter, it's our risk. We have to be very, very good on the data side because when you don't have personal guarantees and you don't have, you know, hooks into the assets of the company, your metrics have to be correct.

And so, this has been a .....we started this company in 2015 so there has been a lot of iterations. I mean, I can tell you that early default rates were probably like 20% because we were truly like building a brand new model, right. We're giving capital to this group of customers, we're doing it on traditional credit scoring models and our thesis was data would be more predictive, but for data to be more predictive, you, unfortunately, have to lose a lot of money.

Peter: Yeah, you're not the only one who finds that out. (laughs)

Michele: I know, it's really, really true, and so now, that thesis is played out and certainly, your know, the data has been more predictive.

Peter: I imagine that you've got a system in place now where....you know, where if you look at the ad data, you look at a lot of the other data that you've been able to produce because you've got a really.....I mean, you're a really unique lenders here insofar as .....I mean, most lenders are not taking personal guarantees, they're taking whatever security they can get, and because you're not doing that, I can imagine, you're a data analytic-heavy business, I imagine.

Michele: 100%. No, we have a big data science team, we have daily monitoring of how each of these companies are doing and then, we're trying to use all that data to be the most helpful to our company as well because if we're seeing something that's happening, you know, as a company we can reach out and say like, what, can we be helpful before something goes wrong.

Peter: Right.

Michele: But, yes, it is, our data science team is asset.

Peter: Yeah, yeah, okay. So then, can you maybe give us a sense of the scale you guys are at. You started in 2015, maybe just let us know like how many advances did you do last year, for example.

Michele: Yeah. So, last year we invested just shy of a billion dollars and to over 2,000 different companies, so it's quite a broad range of different e-commerce companies we've been able to fund.

Peter: Okay, and are you doing this...because you're Canadian, right, and so you're based in Canada. Is this for the US and the Canadian market, or how do you...where do you operate?

Michele: Yes, when we started Clearbanc we actually did so out of the YC Fellowship in San Francisco, and because the founders were Canadian we had great recruiting circles, we moved the company back to Canada by the year end, but our primary market has always been the US. We have launched in Canada and we have, you know, a bunch more international launches that we will be able to talk about later this year which is exciting because, you know, overall, it is really hard to raise capital in the United States, but globally, when you look at it, it's even more difficult.

The venture system is less sophisticated, things are even more conservative, I mean, in India there are places that will do equity deals, personal guarantees attached to the family and so there's a lot...isn't that crazy. There's a lot globally where we think we can do that and we're working on that journey now.

Peter: Well, I imagine too, if you keep the sort of Google and Facebook thing…..I mean, how many countries they're in, they're in just about every country that has any kind of infrastructure. So, I imagine, this would translate...or maybe you could answer the question. Does it translate easily across borders, given the fact that you are particularly looking at the Facebook and Google ads kind of analysis you do.

Michele: Yeah. I think the needs translate across border really well because, at the end of the day, founders have the same needs for the company and they're using the same tools internationally, as they are in the United States, especially on the algorithm side. I think what is hard and challenging that we have learned is that as a fintech operating multiple jurisdictions in a heavily regulated industry, it takes time and patience and understanding of, you know, individual laws in a lot of different places. So, that's our work, but we think the opportunity is certainly there.

Peter: Right, right, okay, that makes sense. So then, who do you see as your competitors here? I mean, it sounds like....obviously there's venture debt. If you've raised equity capital you cango to Silicon Valley Bank or other places, then there's also like....I think you've got merchant cash advance companies that have a similar kind of percentage of revenue type things. Obviously, there's plenty of online lenders, but who do you see as the....like when you lose a client, where do they go to, so who do you see as a major threat?

Michele: Yeah, no, that's a good question. I think, you know, the way that we thought about this world is that we want to be the best alternative to equity which is currently, you know, what happens going towards you now with Facebook and Google. So, this category has really been funded by equity dollars, but sometimes can feel, you know, not expensive, but as soon as you have an exit and understand what it means to have a liquidation preference and control and the board and, you know, losing a lot of the control you've had as a founder, you know, equity starts to get more expensive. Plus, in terms of IRR, you know, like equity can be extraordinarily expensive to you, especially if you are successful, right.

Peter: Right.

Michele: Especially if you're successful, it penalizes and so that's how we've always thought of positioning and talking about our product.

Peter: Right, okay. So, you're not really....I mentioned you worked with VCs, right, because not every VC wants to.....they want it to be a "win win", so are you partnering with like Silicon Valley VCs?

Michele: Yes, I mean, if you think about it like the average VC might see 400 companies here and do 4 deals, and so they've been great partners of ours in terms of both funding the companies that are not a fit for them, but also funding companies where they don't want founders to take more dilution, right, because as soon as the VC is on a cap table, they want to be diluted the least as well because the incentive there align for that to be used. I mean, you're right, venture is available for companies that have existing venture capital, but it also has a covenants, and warrants, and a lot of complications around this. We've made our products, you know, much simpler.

Peter: Right, okay. So then, what about funding your own company.....like you obviously have a funding line, but you've also, I think, raised equity capital. Talk us about how you gone around funding, both on the equity and debt side of your own company?

Michele: So, the way that we have funded Clearbanc is we've raised some equity capital to build new products and to grow internationally, and we've also raised our own series of GP/LP funds that allows us to fund our investment in e-commerce companies. So, you know, that was our structure because we had a lot of controls to change underwriting criteria to really experiment, so we fully own the GP and we have LPs that contribute and the LPs have been other founders, people like Jason Finger that started Seamless. He was like, I 100% have this problem, you know, I wish this product would have existed when I was around and it's really helpful in getting family offices and university endowments so we could have the money to invest in these companies

Peter: So, you're not talking to banks to provide like a funding line for this?

Michele: So, we started with doing our own GP/LP line which is in-house, because, again, banks have used traditional methods for a long time and they are used to a very structured approach. And then, we were able to, you know, leverage future funds as we continue to grow so then you get a bank piece of that as well.

Peter: Right, okay. When a bank first looks at what you're trying to do, they'll probably think it's crazy because you're not even taking personal guarantee. So, I can imagine, that initially that was not on the table. Now, you obviously have a track record that you can go obviously and shop cheaper sources of capital, right.

Michele: Yes, and that happens with time, right, as soon as you build a new model.....you know, it takes three, or four years of data to show that this is working and everything that you've built and then, certainly, we can look at doing that.

Peter: Right, right, okay. So, other things you're doing like the Dragon's Den, then you said....sounds like that just is like you take like a vacation from your work, you go and intentionally do that, is that sort of how it works, or are you....I'm just trying to get a sense of how much time you have to take away from Clearbanc.

Michele: Yeah, Dragon's Den is actually very efficient at this point, we basically do it all in a two-week period where we go over the weekends, we do 12 hour days and we film the whole season in one go. Now, this is my 6th season, so I've been doing this for a while and so my team understands how to work around that and we typically wrap. You know, early in the evening if I need to come to the office, we can continue to get things done.

Peter: Right, and your office is in Toronto, right.

Michele: Yeah.

Peter: Okay, great. Anyway, so we're just about out of time, but before I let you go, what's on deck for you guys, what's happening in 2020. I know you said you've got some announcements, but maybe in broad strokes tell us where you're taking Clearbanc?

Michele: Yeah. So, I think this is a big year for us to be growing internationally, for us to be looking at new verticals, some of the things that I talked about earlier, in terms of going beyond the typical e-commerce and app company into a far broader range. And, ultimately, like helping the balances power so that founders have more power in these relationships because for such a long time the venture capital provider had all the power. We think that if we can help founders, you know, efficiently capitalize their company and understand how to spend those dollars, we can have to greatest impact for founders.

Peter: Okay, well that is certainly a noble cause and I think you're making many of the entrepreneurs much wealthier in the long run than they would have been if they hadn't used you guys. Anyway, Michele, I really appreciate your coming on the show today, thanks a lot.

Michele: Thank you for having me, it was wonderful to be here.

Peter: Okay, see you.

I love companies that provide new innovative ways of financing and this truly is innovative. The fact that they have been able to get into, you know, Google and Facebook ads and see their effectiveness to be able to sort of get their company going and providing founders......this 40% of venture money going to Google and Facebook is just crazy. It should not be the case, as they pointed out. So, I think for those companies looking for alternatives, Clearbanc is an excellent way and really a pretty inexpensive way to attract capital.

Anyway on that note, I will sign off. I very much appreciate you listening and I'll catch you next time. Bye.

Today's episode was sponsored by LendIt Fintech USA, the world's largest fintech event dedicated to lending and digital banking. It's happening on May 13th and 14th, 2020, at the Javits Center in New York City. Lending and banking are converging and LendIt Fintech immerses you in the most important trends of the day. Meet the people who matter, learn from the experts and get business done. LendIt Fintech, lending and banking connected. Go to lendit.com/usa to register.

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