diffusetap
Virtual Event Series

Fundraising via Platforms

Guest Speakers:

Mike Cavanaugh
Managing Partner
Regiment Alpha

Nelson Chu
Founder and CEO
Percent

Hosts:

Kenny Estes
CEO and Founder
Diffuse

Ayla Kremb
Chief of Staff
Diffuse

DiffuseTap: Fundraising via Platforms

Last time on DiffuseTap, Mike Cavanaugh, Managing Partner of Regiment Alpha and Nelson Chu, Founder and CEO of Percent, talked to us about the difference between fundraising via platforms versus direct, how platforms are fulfilling the need for quality private debt products, and the key benefits provided by fundraising platforms that direct investments inherently lack.

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DiffuseTap

This networking session is part of our weekly virtual events series. Networking (you'll bump into at least a dozen high caliber fund managers) meets purposeful (you'll tap into brand-new sources of ideas) … straight from your armchair like a boss.

Meet the Speakers

Mike Cavanaugh has 20+ years of experience in capital markets and fintech. With his trading background, Mike has held a string of executive positions in advisory firms and brokerages. In 2019, he founded Regiment, a spin-off of FinTech Ranger, a consulting firm for fintechs, alternative funds, and underserved markets.
LinkedIn: @michael-a-cavanaugh

Nelson Chu is a founder, investor, and advisor with a strong background in business analytics. He is the founder and CEO of Percent, a leading financial infrastructure solutions provider that leverages data to enable transparency and efficiency to lenders and credit transactions.
LinkedIn: @nelson-chu

About Diffuse

We are an alternative fund platform offering differentiated investment products. From digital assets to VC funds and beyond, we identify green field investment opportunities we feel will have market beating returns and turn them into professionally managed funds. For more information visit www.diffusefunds.com.

KENNY ESTES: In today's session, we have Nelson Chu and Mike Cavanaugh. I'll hand it over to you first, Nelson, to give us a quick intro on yourself and Percent.

NELSON CHU: Sure, absolutely. Thanks everyone for joining us for the last fireside chat. My name is Nelson Chu, founder and CEO of Percent. We are a global infrastructure solutions provider for credit markets, specifically private credit. Essentially, we create all the tools and the data you need to be able to do a transaction start to finish, whether it's sourcing a deal, structuring a deal, syndicating a deal, or surveillance in a deal. We cover all of these.

We've done close to 700 million total volumes so far in what we'd like to call our own little public beta. A lot of work has been done and has been going on to open this market up in its entirety by the end of this year. It's a very exciting time to be part of this company, and I'm happy to talk about that as we dive into the questions.

KENNY: That was super-efficient, I absolutely love it. That's not your first rodeo. Percent was formerly called Cadence, for some of you might know the company under their former name. That's how I first ran into them. Mike Cavanaugh, you are up. You're another one of our few repeat speakers, so welcome again.

MIKE CAVANAUGH: Thank you, Kenny. Hello, everybody. Thanks for taking the time. My name is Mike Cavanaugh and I am the founder of Regiment. Regiment is a financial services ecosystem for what we call the money 3.0 movement. Amongst our family of companies is Regiment Securities, which is a FINRA approved broker dealer. We utilize a technology platform that allows us to address the operational inefficiencies in a private capital raise. We white-labeled the platform from a company here in Chicago called WealthBlock. We're an investor in that company and they've been a great partner for us, allowing us to utilize the platform to raise money in private markets.

AYLA KREMB: Beautiful. I'll just hop right in with the first question. Maybe we'll kick off with Nelson. How did you actually get into the game of fundraising via platforms? How did you come up with this idea, and what drove the development of the platform?

NELSON: I would say it's by accident. That is probably the best way to put it. I have been in finance since the start of my career. I was at Merrill Lynch for the last two months of Merrill Lynch's life, until it became Bank of America, and then, I joined Blackrock after that. I spent a whopping two-and-a-half years in that space, until I decided I will never work in finance ever again. Obviously, those were famous last words, because I am knee deep in finance at this point.

I thought 2012 or 2013 was a good time to start a company in New York because the New York tech scene was starting to get really, really hot. And we figured, "yeah, we might as well. How hard could it be to start a company?" Well, very quickly I realized it's actually very hard to start a company, let alone blow it up.

Within six months, I was broke. And when you're broke, you become a consultant. And so, my startup became a consultancy that helped other founders build from the ground up.

I dedicated seven years to helping these founders do product marketing and brand engineering to get companies off the ground, and I saw a lot of really interesting companies along the way. One of them was in the private credit space. For those who don't know, private credit involves all things small business lending, consumer lending, and things like that. Essentially, all these non-bank lenders emerged after the global financial crisis and stepped in and solved what the banks couldn't do any more.

These guys have been fantastic and growing. But oftentimes, they need help on the other side to raise the debt capital, to be able to fund these loans. With the clients that we had in the private credit space, we started to see the opportunity to do something different from other crowdfunding platforms out there at the time.

There was a need for super high minimums. It was like $25,000, which is not really approachable for the average person. There were super long lockups that could last up to five years, which we thought was crazy given the assets themselves were pretty short duration. And the yield was pretty good at 9 to 16%. And so, we thought we could build a better mousetrap than what was out there, and make it extremely attractive to anyone and everyone as a result of that.

The evolution of companies into what I talked about earlier in my introduction was very natural, just from seeing the pain points in the industry, and recognizing that the problem is more than just the crowdfunding platform. It is a real technology pain point that we needed to solve, and that's how we evolved accordingly. Long story short, I accidentally had a client, and then here we are today.

MIKE: Cool. My story is very similar. I almost feel like I got forced into the money 3.0 movement that we're taking part in here at Regiment. I had a small consultancy firm called FinTech Ranger. We recently changed the name to Regiment, as in a group of rangers. We've expanded outside of fintech into real estate, private equity, and venture capital, as far as the services we offer.

In 2016 was 2017, we saw that cash was starting to stockpile, and it was flowing into traditional capital markets at the slowest pace ever. That reminded me of a movement which I participated in. I was in a couple of different movements in the past. One was the algorithmic HFT trading in the futures market in the early 2000s. I was a pit trader at the Chicago Board of Trade, where it was six bid at seven. That type of market went into HFT algos, which were connected directly to the exchanges. Eventually, all of that went away. And today, we're seeing technology newly integrated into financial services, with this blockchain crypto movement coming into play.

The fact that more money was sitting in cash because of a global void in yield in traditional fixed income markets, the stock markets at all-time highs made less and less sense to the sophisticated investors. As cash started stockpiling, we started seeing that more and more people were looking to alternatives. People were putting their money into asset classes that were still immature because they practically didn't have any other place to go in more mature traditional capital markets.

That's really what got us into building the ecosystem for the money 3.0 movement. The market forces were just prime, and they were begging for groups like us to step up, educate, evaluate, and then execute their investments in the alternative market space.

KENNY: That's great. And about your comment on floor traders moving into high frequency trading, I'm sorry about that. (laughs)

MIKE: No, it was a great lesson. I learned so much from it. I was practically in one of the first industries to ever be completely replaced by robots. If you think that your industry can't be replaced by robots, I would kindly disagree with you. It's actually a great lesson to learn and apply to the current movement, with the technology behind cryptocurrencies and blockchain. It's pretty fascinating.

KENNY: Gotcha. And obviously, streamlining is a key element. Nelson, back over to you. A lot of the audience members here are going to become alternative investor sponsors, or allocators. That includes both sides of the marketplace for you. When they're looking from both those lenses or pick one, what type of platforms are out there? What are the larger buckets that you can chuck them into? What is the state of play?

NELSON: Yeah, I think there is no shortage of opportunities to invest in alt today. I think there's an explosion of new asset classes, and all those things have become pretty fascinating. I feel like that has accelerated dramatically through COVID. There are collectibles. There's obviously crypto, and there are NFTs. There are obviously a lot of equities. Everyone became an options trader through COVID. It's just kind of insane. And so, it's a big question of where you should put your money.

And while I don't recommend putting all your money on Percent — I love them, but it's just not a really sound strategy. I think you have to earn other returns and alpha in other places — what differentiates Percent is in our ability to provide transparency in the underlying asset performance. In the private credit markets specifically, if you were to invest in something like LendingClub or Yieldstreet, or all those different places in the past, you're not really all that sure how well those assets that you've invested in are performing. It's just not part and parcel of what they do.

We thought, in addition to the lower minimum, shorter durations, and comparable yields, we felt that better transparency was critical to what we do and is what investors should have access to. That idea has driven a lot of our technology development around creating a standardized, normalized dataset that any investor can use to compare how one deal is different from another. And then after they make an investment, they can find out how it's performing relative to other investments. They have all of that information available to them.

If that is something that is valuable to you, which I hope it is, and generally, if you're being a good asset allocator, that transparency and ability to monitor performance is fairly important. I think giving the ability to market the market in terms of how it's actually doing allows us to stand out above the pack. That is absolutely core to what we do. Transparency is the name of the game, and it creates a more efficient marketplace as a result.

KENNY: That makes a lot of sense. We work with a lot of marketplaces or exchanges, and the biggest inefficiency we find is information asymmetry. The owners don't know a lot more than the buyers, or the would-be buyers, so I guess how you overcome that with transparency is key.

Mike, same question to you. Obviously, you're coming in from the other angle. Nelson's actually doing the platform, but you're white-labeling one and using it to do capital raises. What do you see is the state of play? What were the bucket list items when you were deciding who to partner with on the platform side of things?

MIKE: To Nelson's point, transparency is definitely the number one thing for us. There's always that factor of garbage in, garbage out, and where you are getting the data to provide the information to the investor is important. The hardest challenge in private markets is getting that information. So, we do our own due diligence to come up with the reporting on that. I know that wasn't your question, but I just wanted to get that in.

For us, when we made the decision of what platform we were going to white label, we looked at everything in the marketplace, and it really came down to partnerships. We chose WealthBlock because they've got a great platform there, and their technology is amazing. I also think we caught them at the right time, when both they and we were just starting.

We actually were their pilot customer, and they were really flexible with us in working together to come up with a platform solution for us to execute on. In my experience in capital markets and fintech over the last 25 years, I think that's the biggest point when you're starting out. It's really about creating and crafting the best partnerships, where there's alignment with your partner. We have that alignment with WealthBlock, being their first customer.

They're great technologists, but their capital markets experience was a little less. So, we helped them form an advisory board with some capital market experts. In fintech, I think forming those partnerships at an early, early stage and keeping those partnerships aligned is key. We found that with WealthBlock more than anyone else in the marketplace at the time. Most of that has to do with the fact that we were lucky enough to find them when they were just starting out, and we were able to talk to them and really focus on the partnership.

They've expanded during COVID, and now they have 70 plus clients in their client base. It's been really cool watching them grow since the beginning.

AYLA: One of the things that you mentioned there was different asset classes, which ties into a bunch of questions asked in the chat. What asset classes do certain platforms support, and why and why not? Maybe we pick it up with Nelson. Why is it that Percent has chosen to not venture into VC, and how did you pick the verticals that you're in? How did you pick your asset classes?

NELSON: That's a great question. I think, from our perspective, we saw the gap in the market and the need for a truly quality private debt product. Again, that includes all things small business lending, consumer loans, factory receivables, equipment, leasing, litigation, finance, etc. Everyone else who was doing those at the time were really just not that great.

From our perspective, the big gap was on that transparency side of the equation. If I don't know how this investment is doing, and I have a five-year lockup on my investments, that's a pretty tricky situation to navigate. And also, the interest payments, the principal pay-downs were just extremely uneven. It just happens when it happens. We thought there was a lot of value that can be done in a much more predictable way, wherein if it's performing, interest pays out on this date, principal pays out on that day, and you know exactly how it's performing by watching and looking at those surveillance reports.

We have not veered into VC and startup crowdfunding, or equity or fundraising because it's just a very crowded space. You have the AngelLists of the world. You have the Republics of the world. You practically have anything and everything that is focused on VC and startups. And when it comes to those types of startups, it's actually very difficult to stay true to our model of providing transparency.

Any investor who's in that type of investment likely doesn't have information rights around how the company is doing. You're practically just investing in it and hoping that it comes back. And with the usual model, I would say probably 95% of companies go nowhere, 4% will probably return you the money that you put into it, and then only 1% are the absolute moonshots that do really well.

That is not really something that we feel we can actually be competitive against, nor does it stay true to the model of monitoring the performance of the company. So, we just veered away from the VCs because everyone else was doing it, and it's difficult for us to get what we want out of the companies in order to be on the platform. We have looked at other stuff. I think there are some questions about crypto as well. We're not actually focused on crypto much, if at all. We do have crypto companies on the platform, but most of them are lenders. We are focused on private credit, which means lending.

But to that end, there is no shortage of crypto lenders who need capital on the other side to support what they need to do on the actual lending front. And so, we have a handful of them on the platform. We’re definitely not averse to it, and we actually liked them quite a bit because it's theoretically a fully liquid asset that can get margin calls on the way down. In which case, there should be very little chance of default. Still, theoretical things can go south for multiple different reasons. But conceptually, it is a very good asset class.

MIKE: Yeah, we're looking at all different asset classes as well, and it usually comes from the demand of the client. What we really need to focus on is cycle-tested managers. If they're in a new asset class — which, you could argue that pretty much every manager in the crypto space is a new manager — you can't ask “how did you perform in 2008?” because crypto wasn't around in 2008. It's really hard to find who the best managers are in new venture capital, new real estate, or new private equity.

To overcome that, we have to look at cycle-tested managers. These are managers who focus on risk management, whatever asset class they're in. If their background is in VC, then it’s very different from crypto. There are no data points. You can’t ask “how did you perform the last time there was a global pandemic that shut down 88% of the globe?”

We're all starting at ground zero there. Nobody has a reference point. Even Ray Dalio can't tell you what he did the last time the globe shut down because of a pandemic. So, we really look at the cycle testing and risk management parameters of a cycle-tested manager in any asset class, and we're seeing great stuff in venture capital, as well as in real estate and private credit.

KENNY: Right, appreciate it. Nelson, back to you. This is more of a nuts-and-bolts question for the users of your platform. Let's say you've got a customer sponsor, and they're putting something on your platform. What are some common misconceptions? Do they just put it on there and expect the money to roll right in? What does that actually look like? What is the reality of that workflow, and what don't people realize?

NELSON: Sure and let me just clear this up. The two types of customers that we have is (1) the investor who's putting money in for a return and yield and (2) the lender who's looking for debt capital. Which one are you referencing here?

KENNY: This is more about the sponsors, or the people putting money on the platform for returns.

NELSON: Got it. I think the name of the game for all this is diversification. These are individual investments into specific lenders themselves, So, in the entire portfolio of loans, there's a lot that can go right, and a lot that can go wrong. And in the end, when something does go wrong, you have to go through a traditional workout process which the credit funds and the asset managers of the world are very familiar with, because of certain freak accidents that may happen, such as COVID.

We're pretty proud that our default rate is around 2%, all things considered. But still, it's 2%, more than we'd like it to be. And so, we've navigated defaults as best as we could throughout this process. Let's say you are diversified and you have $100,000 to invest. If you put 10,000, into 10 different investments, then you'll probably do pretty well in the grand scheme of things. You'll be able to capitalize on the return profiles that we have here.

Our return profiles range from as high as 20% to as low as 8.5% percent, which is commensurate with the risk that goes along with it. For something that's super high such as 20%, it's likely that it's subordinated in some way to something else that's more senior. For something that's 8.5%, then it's likely to be an asset class that tends to perform because there is collateral behind it, specifically around an invoice, or factoring, or something like that. It really just comes down to the appetite of the investor who's looking for a return.

We are currently working on products that provide diversification for the investor from the get-go without having them to worry about it themselves, which we're very excited about. That should alleviate some of the concerns like, "Should I put a quarter into emerging markets?" or "should I put 5% in domestic and split this money 50-50 on flexible business and consumer?" That's a lot to worry about, and we're trying to get it out of their hands to just make it a lot easier.

KENNY: Mike, over to you. When your clients come to you and you get them on your WealthBlock white-label solution, what are some misconceptions around them doing the raising platform versus direct? Is it fly-by-wire, or is it more involved? What are your thoughts there?

MIKE: That's a great question. There are other solutions in the marketplace. It comes down to the fact that the platform helps them with operational inefficiencies. It's not the deal closer for an investor to decide they want to invest in it. They don't come to our website and go "wow, this is such a great platform. I like how easy it is to use. "

It is easy to use on the operational side, but it's not the deal sealer as far as getting people interested in investing on the platform. The attraction really comes from showcasing high quality deals by cycle-tested managers. And if anything, the platform is there to help with the inefficiencies. But it's not the deal sealer, so to speak.

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