LEND ACADEMY

PODCAST TRANSCRIPTION SESSION NO. 129-ETHAN SENTURIA

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Peter Renton: Today on the show, we have someone a little bit different, sharing a different kind of story with us. I'm delighted welcome the CEO and Co-Founder of Dealstruck, Ethan Senturia, onto the show. Now Ethan founded Dealstruck in 2013, they were an online small business lender. They actually went out of business in late 2016 and what's really notable about this is that Ethan has actually written a book about his entrepreneurial journey all the way through the founding of Dealstruck through it's dissolution and I wanted to get him on the show to share some of the things that he's learned along the way.

The book was a fascinating read, I found it really revealing and learned a lot about the inner workings of his company and about Ethan himself. I feel like it was a brave and courageous thing to do to be brutally honest about his own shortcomings and the reasons why Dealstruck didn't make it. So we go through all of this and more in the show, I hope you enjoy it.

Welcome to the podcast, Ethan.

Ethan Senturia: Thanks, Peter, nice to be here.

Peter: Okay, so why don't you give the listeners a little bit of background about yourself and what you did before you actually started Dealstruck.

Ethan: Absolutely, so I grew up in Southern California, the son of an entrepreneur, spent a lot of time in startups as a young child and ultimately went off to business school as an undergraduate thinking that I wanted to follow in my Dad's entrepreneurial footsteps. When I got to Wharton which is where I went to school, went the finance track and made the leap from Wharton to Wall Street and started my career at Lehmann Brothers on the distressed bond trading desk which was ironically within the most distressed company there was in this space at the time.

Anyhow, so I probably should have been doing research on ourselves, but stayed there for a little bit and went through the bankruptcy which was a formative experience for me early on in my career to realize how fragile even big historic institutions can be and sort of looked around at a thousand person trading floor and said, I don't think I want to be like anyone here.

So moved back to Southern California and got into entrepreneurship, had the fortune to meet up with some friends and build an internet marketing company for my first go around. My second venture was Dealstruck in the financial technology/alternative lending space and that's where I spent the last five or six years before finding myself where I am now.

Peter: Okay, so let's go back to those very early days. What was the opportunity that you saw when you decided to start Dealstruck?

Ethan: There was a huge market opportunity on paper in the small business lending space to combine unique and fair products with a better delivery system than what banks were doing at the time. We sort of had seen this back in 2012 as Lending Club and Prosper were just starting to get institutional capital and really get attention for the fact that what they were doing on the marketplace and peer to peer side, filling the gap where banks had stepped away or never were for consumers was something that was going to happen, needed to happen in small business.

So you combine this market that on paper looks extremely large, you had still record low interest rates, you had pretty significant anti-bank sentiment and it seemed like a perfect confluence of events to try to stick ourselves in the middle of the small business market and do something different. Certainly, those factors, a lot of them, are still there today. I think the biggest thing people are starting to learn or trying to figure out is how this market that on paper looks so big, in practice can seem so small.

Peter: Right, so let's talk about those early days a bit more and talk about how you went about initially funding the company, going out and raising money. How did you go about that?

Ethan: Sure, so the harder task early on actually was…we started the business as a marketplace and we ended the business as a direct lender lending off of our balance sheet. In the marketplace model, we needed to get enough investor interest to have some sense that if we found a deal to do, we would actually be able to fund it.

And so I went on sort of a founding lender tour and what most entrepreneurs have to do trying to get seed investors/angel investors into their equity I did for the debt and these were…started with concentric circles of friends and family and then friends of friends and extended family of my family and then eventually starting to get into people who, you know, were sort of arms length investors or third party investors.

But it was walking into a room telling them...wouldn't it be great to lend to a small business and get, you know, 8,10,12% return for it, making the pitch and when someone said no you just went on to the next and on to the next until you found enough capital to try to launch.

Peter: And then what about on the equity side of the business? Obviously, the lending capital is one piece, but you need operational capital. Was that a different type of ask that you went around doing that to raise equity?

Ethan: Yeah, so we didn't have a huge equity need early on. It was myself and my co-founder and neither of us were expecting or taking pay out of the business so we didn't have much to spend on until we actually got the lending capital rounded up, but on the equity side, you know, I wrote a check, my Dad wrote a check. It wasn't a significant amount of money, just to get us enough in the bank account to be somewhat credible and be able to pay some lawyers some fees and buy basic tools to get our website up and running.

The initial kind of angel investors in the equity ultimately had a high overlap with people who wanted to invest in the loans themselves too so in the early days, not quite like in the institutional world where you have credit funds and venture capitalists or private equity funds. You have high net worth investors who sometimes want to buy a lotto ticket, sometimes want to buy some current income through a credit instrument.

Peter: Right, so we first covered you guys on Lend Academy, it was just about four years ago and I know you got some pretty significant coverage in The New York Times soon after that. I don't think Lend Academy was necessarily responsible for that, but tell us about sort of those initial days when you...I know that the The New York Times article was a pretty seminal moment at your company. So tell us a little bit about sort of getting going when you kind of felt like you had some momentum and you got on the map with that sort of coverage.

Ethan: Yeah, it's interesting because I always had thought that PR is sort of goofy (Peter laughs) and doesn't have a lot of substance behind it, but I definitely learned that it's absolutely necessarily.

As for The New York Times article, it was a significant boost for the company. It all came about because I had a really great team member who...probably a lot of people listening to this know Candace Klein who had joined our team and really focused on all of our events and outreach and PR. She had kind of put me through "charm school" (Peter laughs) and when I was at a conference I met a New York Times reporter and I spent an hour, hour and a half talking with her, didn't really know what she was going to do with whatever I said and a couple of weeks later there we were on the front page of the business section.

The business sort of took a step function up for the first time in terms of applications, and funded volumes and it never really fell below that. I think it's hard to say whether we would have found our footing and gotten a boost from some other way had that never happened. But it certainly was one of those kind of fortuitous things that we didn't really know what was going on and when it landed we were energized and it...for the next five years that article continued to drive organic traffic to the site.

Peter: Yeah, so when we chatted four years ago, you were offering term loans, 12 to 36-month terms. I know that you added like a line of credit type product. Can you just talk us through the products that Dealstruck offered and sort of the mix between the term loans and sort of the line of credit product?

Ethan: So we had a couple of different products, one of the theses that we had when we launched the business was that the way to be really efficient acquiring customers, which is expensive and difficult to do in this market, is to be able to have products that met the various needs that a small business would have. So we had terms loans which were relatively vanilla, 12 to 36-month fully amortizing products, we had two revolving products.

One of them was an inventory credit line where a borrower would get a credit limit and be able to submit purchase orders so that we would fund them directly and then they would pay those back on a shorter amortization and be able to have multiple draws outstanding at a time. The other product we had was an invoice-based product, sort of a small ticket ABL where B2B companies that needed to borrow against future receivables could accelerate cash from those lines.

Those products in and of themselves are totally viable. I think as we went out to launch the business we heard sort of two things. On the one hand, people really believed the thesis of having multiple products to lower acquisition cost, retain customers, increase lifetime value. On the other hand, some people would say...well gee, don't you think it's going to be hard to do three different products instead of focusing on one. You know, probably 50% of the people were in one camp and 50% were in the other, the people who thought it was too hard didn't invest and the others did and I think that's where you see today that those product lines in and of themselves are their own significantly backed venture businesses.

So if you look at the BlueVine's and the Fundbox's of the world on the invoice side, and P2Bi and then on the inventory side you have folks like Behalf and others. Trying to put all three of those under one roof without nearly the capitalization that they had was probably too much to do, but I think the products in and of themselves are relevant and I think we were good in that sense of being sort of a product shop.

Peter: Sure, so then can you tell us how the loan volume went? What were you doing at the peak, I mean, how much volume?

Ethan: I think at our peak, we were around $7, $7.5 million per month and that was sort of a long slog all the way through and I think others serving this mid-prime market where the loan sizes are a bit larger and the underwriting is a bit lengthier and more judgmental than automated have the same experience where there was really no magic bullet to scale the assets we were originating.

So we ultimately got up to a respectable amount of volume and had a real presence in the space, but there were no days where we just woke up and turned on the machine and saw ourselves double or triple. It was just kind of a steady grind and I think that experience probably isn't unique, based on sort of where others who we competed with in the past have sort of ended up.

Peter: Right, and so then at the peak around then who were the investors that were funding...you said you morphed into a balance sheet type operation, but who were the people that were supplying you capital or companies supplying you capital?

Ethan: So most of our capital was from sort of credit hedge funds and alternative asset managers, some notable names in this space we worked with, you know, Jacob Haar at Community Investment Management. We worked with Brendan Ross of Direct Lending Investments, we worked with a hedge fund out of New York called Brevet, all of whom were really good partners to us. But we had a few different facilities and that was quite beneficial certainly as things got a little bit challenging to be able to, for a while, not be beholden to a single player, but mostly it was institutional capital.

Peter: Right, so then I'm curious about...we saw the investor pullback happen…it started to happen sort of very late 2015, but in early 2016, we definitely saw on the consumer side, anyway, the investors started to pullback capital a little bit. Several platforms were noticing that they couldn't originate as much as they did in 2015 and I'm curious to know if you noticed that at Dealstruck as well on the small business side.

Ethan: Well, you know, we never experienced a pullback from our own set of lenders in the sense of someone kind of pulling the rug out from under us. We had a very committed group who worked with us and obviously this is a story that didn't end up well. We shot ourselves in the foot and I didn't lead the company as well it needed to be led to have a good outcome and so credit to the partners we had who stuck with us and continued to provide us liquidity and work with us as things got hard both in the industry as well as in our own sort of circumstances.

Where we really saw issues was when we...what we needed to do ultimately to try to right-size the business and get ourselves to dry land, if you will, was to reduce our funding costs and to raise equity and that's when the headwinds really hit us, not within the set of investors that we had committed to the company, but really in trying to go out and get to that next level where the company would get far closer to a neutral cash position. So that was a difficult time not just for us, but certainly for a lot of others.

Peter: Right.

Ethan: But the issue was really, you know, the folks outside of the Dealstruck walls, not the ones already in them.

Peter: Right, so let's talk a little bit about that because...I mean, in your book you talk about the events of May 9 at Lending Club which obviously has been talked about and written about ad nauseam for the last 18 months. Correct me if I'm wrong, but you were out raising equity, I believe, around that time, just tell us a little bit about what it was like pre-May 9th and post-May 9th and whether or not...how much of a difference that event made to a business like yourself that was fairly unrelated to Lending Club but still obviously, I imagine, others didn't see it as unrelated. So tell us a little bit about that time period.

Ethan: Yes, so before May 9th, we had a challenging capital raise ahead of us, no doubt, simply because of some of the setbacks that we had in the business and some of our credit portfolio. It wasn't going to be an easy raise before that, but certainly we were having some reception and the likelihood of there being something, even if it was painful, was probably somewhat realistic, but on May 9th, it was actually one of my more memorable events.

I was actually pitching an interesting VC that was related to a big consulting firm and I was in front of ten partners at this consulting firm who were in their banking practice or financial institutions practice. Literally on May 9th, and I sort of got up in front of the room and my friend who worked at the fund had asked me to come present to them and he was sitting at the back of the room and I get up there and I say…oh, we're Dealstruck, we're a platform for online small business lending and I guess I sort of need to address the news that came out today because clearly that's the elephant in the room and everyone just kind of started laughing.

I think from that point forward they sort of checked their phones or went on a water break and that was somewhat representative of kind of the rest of the effort to try to land the ship unfortunately, but we were sailing upwind before May 9th due to my own sort of missteps, our own missteps. After May 9th, I think it was hard to even to get an audience.

Peter: Right, and just tell us the time and you write about it in the book, but tell us about the final straw when you realized that you were out of options and the business was not going to make it.

Ethan: Yeah, we really had it down to the wire. We took it out as far as we could before we had to wind down the company appropriately. We actually had a term sheet with a bank, a small bank, to sell the company. They liked the team, the technology and liked the product and the markets that we were in so we were in a closing cycle with them trying to get a deal done and I had been told by a couple of people...ah, small bank, the deal will never happen. I said yeah, yeah, maybe this time is going to be different, maybe this time is going to be different.

Ultimately, I think, we had a small bank that was looking at a transaction that for them was not insignificant and had a little bit too much hair on it so couldn't get everyone to get on the same page with enough time to find a way to get a deal done and sort of had a drop dead date on the calendar where if we don't have a transaction, sort of closing timeline committed to by this day in order to wind down the company appropriately and protect the officers and the employees, the vendors as best we could we would have to call it quits and unfortunately the message came through on a Tuesday that the bank was not going to do the deal, or on a Monday rather, and then on a Tuesday we broke the news to the team and started the next phase.

Peter: So when was that, what was the date?

Ethan: I think it was November 15th, I know it was right before Thanksgiving which made it pretty brutal for me because I felt really bad going into the holiday season with my team because there was not a ton of hiring in that time, and a lot of the people on my team were very high quality people and they weren't just going to want to run into the next…they were going to want to find something that was great for them so it was not great timing, but I think mostly people understood that we tried to do everything we could.

Peter: Right, right. So I want to switch gears a little bit now and talk about the book and you were kind enough to send me an advance copy of it. I read it over the past week and I'd like to compliment you first, I think you've done a really excellent job in conveying the story. It was a fascinating read for someone like myself who has obviously been involved in the industry for a long time. I recognize many of the players and I knew some of the bits of the story, but I didn't know anything about the inner workings at Dealstruck and how things kind of built up and then the struggles that you guys put in. So I guess my first question is why did you decide to write the book?

Ethan: Yeah, for many reasons. You know, I think the biggest reason is to try to be more scientific about learning from failure, to catalogue things. And there are sort of two stories being told, one is the story of a lending company that did well for a while and then didn't do well. To people in the lending business that will be hopefully an interesting story, but for entrepreneurs or people in the startup world outside of lending there's the story of being a young or first time founder of going through all of the ups and downs, the psychological challenges, the emotional roller coaster of being an entrepreneur and how failure really brought out, how difficult those were and how critical managing your own psychology and the psychology of your team around you is, in good times or in bad times.

So ultimately it was to learn to make sure that when I do it again, because I hope I do and I plan to, I don't know in what industry but I think an entrepreneur for better or worse, that I can really know...hey, what worked, what didn't work, what do I need to change with some amount of objectivity. And really the other piece of it was I would like to help people. I think being an entrepreneur is a noble endeavor, it's extremely challenging, I think the learning curve is unbelievably steep and there's really no way to learn it unless you do it and when you look at the literature out there, you see lots of books about people who have been very successful even if they failed early, they've then been successful.

You see lots of people telling you, here's the 20 things you should do to build your company. It's not as much about what you shouldn't do or you might want to be prepared for that isn't particularly glamorous, it's sort of like going into a marriage and being like...I think you should think about divorce or the things that lead you to it so that you know what to avoid and what pitfalls, you know, sort of lay down the road of the dead pool, if you will. So hopefully, some entrepreneurs read it and find themselves either understood or take some insights out of it that help them be more successful...I know I'm going to be one of those entrepreneurs who rereads it and tries to make sure I learn from it and, you know, if people are entertained by it. That's a nice side benefit.

Peter: Well I've got to tell you, you write with a brutal honesty. I would say you really don't sugarcoat anything, as far as I could see anyway, and you sort of talk about your personal struggles as you were going through this process and to me that was one of the most fascinating pieces is it wasn't sort of a sterile, analytical type book about here are the things you should do and here are the things you shouldn't do. It was a journey of one individual's process of self-discovery and self-awareness and how you kind of dealt with the good times and the bad times in this book which I thought was fascinating. So did you find writing the book...was it cathartic in some way or how was the actual process of writing the book?

Ethan: Yeah I mean, so I wrote the book as a memoir because I'm not particularly qualified to tell people, here's a hundred tips to do things well. I mean, I don't have those credentials so I wrote it as a story with some hints about what I would do, but really so that people can take from the situations what they think is valuable, and just think about them in light of their own circumstances.

Funny you say that it's written with brutal honesty; I think it's written with honesty. My view is if you saw a first draft, it probably would have been brutal (Peter laughs), but the point of it was not to antagonize myself, my partners, people who supported me in the journey. You know, I would never have had a chance without them. It was part cathartic to begin with, but the first draft was, man, that felt good to get it out on paper, but as I went through the second, third, fourth rounds of editing and drafting and having other people look at it and making me think about it, it became a much more objective exercise where it almost was like doing a case study where finally six months removed from the end of it as CEO, I was able to see it with an objective lens and that's where the real learning and insight came from and that's where I think, hopefully, some of the things that are most sort of poignant or stick out to the reader. My guess is that they were written as I got further and further away from it and the stuff that was probably written the day after I laid everyone off may have had a bit more emotion behind it.

Peter: So you said in the book that the number one thing that you would do differently is you would have properly capitalized the business. So going back now, what exactly would you have done to achieve that?

Ethan: Well there's two sides of proper capitalization, it's really about aligning the capitalization that you have with the growth trajectory and product profile of the business. If I had my druthers I would have raised a lot more money and who knows if I would have been successful being able to do that. Early on, I had an opportunity to take a term sheet for a lot more money and we chose not to, myself included, opting to go for a little bit more "capital efficient route".

I think we combined this sentiment of we need to get to a relative amount of scale to stay relevant in the industry when there's 300 other guys that are doing the same business, but we didn't have the capitalization to support that growth and so ultimately, I think we just bit off more than we could chew and it became more than I was capable of managing effectively. But if you look at the guys who are out there who have made it, most of them had early in their business significant financing on the equity side and most them on their second raise, on their Series B had raised well over a $100 million of equity.

I think, look, people who have been in lending and financial services or specialty finance for their whole lives and have far more gray hair than me would probably say, well duh, you need a lot more money, these are capital intensive businesses. And I think the fintech folks, certainly some of them who are newer to the business, either couldn't have landed that capital or didn't quite understand or realize how much capital you needed. So, ultimately, it was...for the amount of capital that we amassed at various stages of our business, you know, we tried to go too fast, too big with them and I don't think I'm the first person who's seen that that doesn't work well, but, you know, that's how it goes.

Peter: Right, right, so then now you've had some bit of time to sort of consider the space you're in, I'm curious to get your take on the online lending space in general today, particularly the small business lending space. What are your thoughts on the impact it's making, on the success of the players and the opportunities?

Ethan: If I had to pick one word to describe the small business lending space, non-bank at least, I would say messy. (Peter laughs) You know, it's sort of this weird market where you have a small handful of well capitalized fintechs or alternative lenders that are really doing more than lending. They're innovating on product, they're innovating on payments, they're really rewriting underwriting technologies and then you have a bunch of smaller guys, certainly in sort of the daily debit or cash advance world that no one's ever heard of that are out there sort of printing money, but it's back of the envelope type origination and so I think it has yet to be seen.

I mean, what ultimately comes of that...I'm ultimately optimistic that someone or a set someones will figure out how to do for a small business what we at Dealstruck and other entrepreneurs who were trying to make the capital markets better for these business owners. I'm optimistic that people will figure out how to do it, but you know, there's sort of this competing battle between those who are trying to build brand and do it right for the long term and those who are just kind of skimming off these small businesses to make a quick buck today. I think the latter can get in the way of the former so we'll have to see what happens longer term.

But net-net, look, the small business market is still huge and no one has become a gorilla so even the biggest players are in the handful of billions and that's kind of a drop in the bucket. I think there's a lot of room to run, unfortunately, Dealstruck is not going to be running.

Peter: Right, so I'm curious about...it's been almost a year, what you've been doing personally and what's next for you?

Ethan: Yeah, so when you run a company, certainly when you run one that's going through distress, your personal life takes a back seat for better or worse so had a few months, deferred maintenance, if you will, on my personal life that I had to take care of.

Recently have just kind of come to the realization that for as much pain and as much difficulty as the Dealstruck experience was of my own making; I'm not a victim, it was my own making. I want to do it again. So I don't know if it will be in fintech, I don't know if it will be in lending. I'm certainly involved in this space doing some consulting work and staying up to speed on the happenings, but I've also looked at business opportunities outside of finance and lending. So I don't yet know what it's going to be, but I have a feeling whatever it is, it's going to be a startup and I'm looking forward to doing it differently and doing it better the next time around.

Peter: Okay, well we're pretty much out of time, but just one last question. Where can people buy your book?

Ethan: The book is on Amazon so if you go to Amazon and search for Unwound: Real-time Reflections from a Stumbling Entrepreneur, you will find a book by me and it's available on Prime and if you take a copy there's paperback, there'll be a Kindle version, that would be amazing and tell me what you think, leave a review. Contact me, you can visit the website ethansenturia.com and I hope you enjoy.

Peter: And we will link to both of those websites in the show notes. Anyway, I really appreciate you coming on the show today, Ethan, and telling your story and telling us about the book so thank you very much.

Ethan: My pleasure, thanks, Peter.

Peter: Okay, see you.

So personally, I found it very refreshing to read Ethan's book. I feel like being through some pretty challenging times it was great to read how he dealt with them, some of the challenges that he overcame and the challenges that he couldn't overcome and the missteps and the successes. And I feel like to me it was a really informative read and an enjoyable read. I think anyone in the online lending space can relate to the challenges that Ethan went through and as I mentioned, the brutal honesty, I feel like this was something that he didn’t sugarcoat. He was somewhat self-critical, without really being demeaning to himself. It really is a book that I think is not just a non-fiction learning book, but it's a real story, it's a good story and it's an interesting story; one that doesn't necessarily have a happy ending, but it was a fascinating read nonetheless. I can highly recommend it to anybody in the online lending space.

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

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