Episode 23:

The 3 Real Risks in Website Investing

A transcript of this episode.

Welcome to the Professional Website Investors podcast, the show where we talk about what it takes to successfully buy, operate, scale, and sell a thriving e-commerce business. When it comes to doing business online, we believe that buying an existing website is far superior to building one from scratch. So, if you're a career professional who is looking to become an e-commerce store owner, listening to this show will give you the knowledge, tools, and community support you need to be successful.

I'm your host Ryan Cowden, and this week we're joined by Ian Bond from professionalwebsiteinvestors.com. In this episode of the Professional Website Investors podcast, Ian and I discuss the three main risks you will face while investing in websites. Online website investing is one of the new investment frontiers that have really opened up in the 21st century. It's an exciting time out on this frontier. There's a lot of open space, several opportunities and less competition than other, more traditional markets. Alongside these new possibilities is the presence of real risk. There's less research to guide you. There are fewer guides and companions for the journey, and we haven't been doing this as long as other types of investment.

Fortunately, a lot of sound investment principles still apply in these new spaces. Our guide today, Ian Bond, shares the lessons he learned on a different frontier, and how those lessons have served him well in the uncharted territory we all face today. On this episode, you'll hear how Ian's experience on Wall Street in the 1980s informs his current approach to investing. Ian has been investing in new markets for a while, and has learned some valuable lessons that still hold true on the new frontier.

Next, Ian shares the three common risks you'll encounter in a new investment frontier. These include having adequate information, assessing the advice you receive, and minimizing risk. Then, we'll discuss the information you'll need to navigate this new frontier. Venturing into a new frontier means there will be less information than is available in more traditional markets. So, you need to search for information that will help you limit your risk. After that, we will cover how to assess the advice you'll receive from website brokers. Brokers tend to represent the sellers, not the buyers, so make sure you know how to interpret the advice you'll get from a broker.

Additionally, we will go over the ways to minimize the consequences of your decisions. You may want to consider adding an escrow period to your buying process, just in case any new information comes to light that would cause you to rethink your purchase. And finally, we'll share some final tips you can use to minimize your risk on the frontier, including bringing in the input of advisors, third parties, friends and mentors.

If you're looking for ways to navigate the new investment spaces of the 21st century, then this is one podcast you won't want to miss. There's a lot of actionable advice in this episode, so grab something to write with because you're going to want to take notes. As always, I'll be back on the other side to wrap up any loose ends. So, without any further ado, here's my conversation with Ian Bond.

RYAN: All right, Ian. Welcome back to the show! It's great to see you, man. It's been a while.

IAN: Spent some time in Thailand, in northern Thailand. You're out there living the La Vida Loca out in Southern California.

RYAN: It's La La Land.

IAN: Yeah, La La Land. Yeah.

RYAN: It’s a great place to be, yeah.

IAN: Good to see you again. Yeah.

RYAN: It’s good to see you, too! Yeah. Well, I’m really excited about what we’re talking about today. We’re going to be highlighting the three big risks in website investing. But to kick us off here, I thought it’d be fun to take a trip down memory lane and kind of dig into your investing career. So, why don’t you tell us a little bit about how you started off in Wall Street, and what that experience was like?

IAN: Okay. So, the three huge risks in website investing come from a long, long history of investing and making lots of mistakes. I’m mortified to admit to you, Ryan, that I started on Wall Street in the summer of 1980. So, I will be starting my 40th year.

RYAN: Okay.

IAN: You know, in not too long. At that time, longterm US treasury bond interest rates were in the 12% area, and the Dow Jones Industrial Average was at 850-ish, or 800 … I think, yeah. 850, something like that. You know? Today, to give you an example, 30 year bonds are less than 3%. The Dow Jones is over 26000, so it’s been quite a run. I think the reason that this is relevant is that investing in equities back in those days seem pretty treacherous, and though I think most people don’t have the perspective on what I refer to as these three huge risks.

On the one hand, it seems treacherous. On the other hand, as obviously you can tell from the numbers, you’re in front of a huge trend that paid off incredibly well, which is how I get so excited about website investing. So, that’s my background.

RYAN: Okay, cool. Yeah. I wanted to connect that experience specifically to website investing. How did your experience on Wall Street shape your investment approach that you have today?

IAN: So, I’ve invested in illiquid investments for a very long time. Back in the day, a lot of international investing was really considered frontier markets.

When you invest in what are frontier markets today, there are tons of hidden risks you really can't see very easily. These types of risks aren't unique to website investing, and they're more generally applicable to investing in all new asset classes. So, this answer is to how I've come to identify these risks, really, by starting in other markets and kind of getting beaten up for the last almost four decades.

RYAN: Okay. So the investments have changed, but the risks are basically the same.

IAN: Yeah, yeah. I think that's true. An investor kind of always needs to focus on the downside before they put their hard-earned money into something. I've learned through a lot of painful mistakes that you need to handicap a few things going in, and so the questions that I ask myself. Number one, do I have great information on which I can make a decision? Number two, are the parties that are showing the investment aligned with my interests? And number three, and it's a big one, if I make a mistake will the consequences be small? Okay? Those are the three things. Do I have great information, are the parties that I'm dealing with, are they aligned with me? And, how easy is it to undo what I've gotten myself into?

RYAN: Okay, great. Well, I'd love to dive in and unpack those three questions, then. Let's start with the first one. What do you mean by do I have great information to make a decision?

IAN: All right. So on Wall Street today, if I wanted to go buy Apple computer stock, I can probably get 50 research reports, 100 pages in length from very reputable brokers. And, I can compare and contrast their opinions. While I may not know what they're talking about, that's my knowledge and not a lack of information. That's just not the case in what I would call frontier markets or new asset classes. I don't know if that makes sense, but there's a lack of information, not a deluge of information.

RYAN: Okay. So as we go into a new frontier, there's a lot of new territory and there's not a lot of information. You think that's kind of the case with high ticket drop shipping, we're kind of on the new frontier here?

IAN: I think it's true. I think this is a nascent asset class. There are tons of opinions out there. They're not nearly as well proven, there certainly aren't 50 people that can opine on something as specific as Apple computer stock or the type of investment, the specific investment that you're going to look at. You have to handicap what the risks are with the available information. That's a big deal in this type of investing.

RYAN: Okay, great. All right. Let's go to that second indicator then. Are the parties I'm involved with who are showing me this information, are they aligned with my interests? What does that mean?

IAN: Well, in website investing, make no mistake about it. The broker, the website brokers paid by the seller. So, they represent the seller and they do not represent you. That's very different from having a brokerage account, where your broker is hoping to have a longterm relationship with you. Or if you buy a home, your real estate broker is probably a friend of the family, and you're going to see them all the time and they want you to do well. This is just a huge conflict of interest for website investors to overcome.

Most website brokers are really courting sellers, because that's where they get their product. It's buyer beware. But it's stacked against you from both an information and an alignment of interest standpoint for sure. Make no mistake about how nice that website broker is. They want to collect the commission, which is paid by the seller. You've got to overcome that.

RYAN: Okay, interesting. So, maybe we should move onto that third category and just kind of get all the questions out in the open before we dig into them a little bit deeper. The third thing you highlighted was if I make a mistake, will the consequences be small? So, can you explain that a little bit more?

IAN: Yeah. What happens, Ryan, when you close on a website, you go through an escrow period and you verify everything you can. When you have verified everything, you are the proud owner of a very illiquid investment that's tough to get out of on a moment's notice. If you identified a problem after the fact, it's going to be doubly problematic because if you've misjudged it, it could very well be material and there's no market for this stuff. You may literally have a full write-off on your hands, and there are ways to look at things to kind of ameliorate this. But, it's not like … Going back to the Apple computer stock, if I buy it today, I can sell it tomorrow.

Even good real estate is hard to turn around and sell the next day. You can argue that prime real estate is as good as it gets. And everyone listening to this who has been in the real estate market knows that if you buy prime real estate today, you're at a huge amount of risk in terms of if you want to turn around and sell it quickly, if your situation changes or if you think you made a mistake.

RYAN: Okay. Okay, so we don't have a lot of information because we're out on the frontier. The brokers are representing the sellers, and it's hard to resell or get out of this once we buy it. So, it seems like there's a lot of risk upfront. Would you say that going into these investors, we're looking to minimize risk, that's kind of our dominant attitude on this frontier?

IAN: Yeah.

RYAN: Okay.

IAN: Yeah. You try to develop the most prudent plan going in, obviously you've done your homework. You're excited to go forward. You've had seller conference calls, you've asked as much relevant information as you can. And then, there are a few things that you can do I think to protect yourself.

RYAN: Okay.

IAN: If you feel nervous, or if you're new to the game.

RYAN: Let's break some of those down, then.

IAN: Okay.

RYAN: Do you want to go back through kind of the big three? Could we talk about the lack of information, what's something you can do to get more information or get better information?

IAN: Well, okay. Let's think of this as a real estate transaction, because I think it's probably a pretty good analogy. I was interviewed by International Living Magazine recently for an article that they were doing, and they were calling it online real estate. I think there's some strong parallels. In a real estate transaction, you use an escrow. I mentioned it, and as opposed to directly wiring the seller money and then having a dispute later, use an escrow always. Whether you're using a website broker, or whether you're using a third party escrow.

I've not ever had a problem as a buyer using a website broker escrow, even though they would be conflicted because they represent the seller. If you find what you consider to be a material problem, you can throw the towel. I'd be interested if anyone's listening to this, if they had a problem where the website broker disagreed and didn't do it. And didn't agree with them and had a problem, but I've never heard of that. The second thing that I would is get a third party due diligence opinion on any of the areas that you either are not as familiar with.

For a great resource for people that want to get a general opinion, there's a wonderful firm that really is a great buyers or investors resource called Centurica. Centurica is run by Chris Yates, and you can contract with them to do due diligence for you, and you can point them in a direction that you need help in.

RYAN: Mm-hmm (affirmative).

IAN: And then finally, and this is something I've done, find an advisor. Find a mentor. Find somebody from … Find a group of people that you can bounce an idea off of, that know the strategy that you're looking at and know it cold. In some cases, you may even find people that know the niche that you're looking at. At the very least, they can probably give you kind of an off the top of their mind view of things, but they also will have a Rolodex if they've been in the business. You got the network effect, so you can get people who can get people to help you. That's invaluable to me.

RYAN: Sure, okay. I was wondering if there's any advice you have specifically for working with these brokers, as you say that they're more representing the sellers and the buyers. Anything we should have our antenna up for? Are there any code words we should be listening for? How do you deal with those people?

IAN: Yeah. Yeah, stay with the reputable brokers. Okay? We mentioned names before, and you'll do fine. Generally, you're not going to have issues with reputable people. I don't want to overplay this, I just want to point out that as an investor, like in real estate, the sellers pay the commission. People kind of accept that in real estate, and let's not overlook that when we talk about website investing. I would be very suspicious of dealing with someone who is not affiliated with one of the big firms, doesn't have a reputation that they're worried about protecting, is only in there for a one shot or something like that.

The bigger firms are the people that you should deal with. I've had excellent advice from the bigger firms, even when to the extent where maybe I have found something in a listing that I think is questionable. Or, even to the extent sometimes when I've had a listing that kind of like the financials have rolled over. Because of relationships, they have alerted me and said, "Cool your jets. Wait a while, let's see how this looks." I don't want to beat up the website brokers too bad, because I've got great relationships.

RYAN: Okay.

IAN: Yeah.

RYAN: That's even a good advice, build those relationships.

IAN: Okay. To take it to the next level, if you really want to protect yourself, develop the relationships with the website brokers so that you absolutely know they're going to get … If you're going to be a regular investor, you know you're going to get a fair shake. The reality is that most people in the business want to do the right thing. Nobody's really trying to stuff you with a bad deal, especially at the big firms. If you deal with the big reputable guys and you develop great relationships, you're well protected.

RYAN: Okay, great. And then, that final risk you identified was if I make a mistake, will the consequences be small? We've already talked about having an escrow period and working with brokers. But, is there any other advice you have for how we can minimize the risk or keep the consequences small in these investments?

IAN: To be honest with you, Ryan, the only way to keep the consequences small is to put a smaller amount of money at risk.

RYAN: Okay.

IAN: If you're doing a larger transaction where there could be an earn-out, you can shift some of the risk to the seller. You could pay the seller over time on a larger transaction. But, most transactions at least under $100,000, they're going to be settled in cash up front. And so, there's not an opportunity to do much in terms of earn-out or seller financing. So, really minimizing the amount you put up. If you are doing a larger transaction, absolutely shift some of the risk to the seller by doing an earn-out, by doing some kind of a buyer financing.

You can work with the real estate brokers and get very creative to do those things, and people do them all the time. We've done them. It's a great way to make sure that your interests are aligned. Matter of fact, one of the things I love having is having a seller who knows the business really will stay on for a period of time as a minority partner. Let's say 20 to 49% or something.

RYAN: Yeah.

IAN: And have them benefit if the business does really well for that first year. Pay them even higher than the proportion amount, because they're going to help you with the suppliers. They're going to help you with the knowledge gap you have initially. If you can pay for 51% now and pay a higher amount as the business excels and does incredibly well, that's a win-win. I'd much rather have that than be tossed the keys and have somebody say, "Good luck."

RYAN: Okay, great.

IAN: Yeah.

RYAN: Well, we're almost out of time. But, what's kind of your final word for people as they head out to the frontier? What's the last word here?

IAN: I would tell you the old Ronald Reagan quote with the Jimmy Carter presidential election back in 1980. Which I recall was, "You ask the American population if they were better off today than they were four years ago," and it was a resounding no. Okay? You ask yourself those three questions. Do I have great information, are my interests aligned with the sellers, and is it just a small problem if I make a mistake. If you can't answer that yes, then you've got to watch out. Okay?

RYAN: Great. Great. All right. Well, thank you so much. This was really great. Thanks a lot, Ian.

IAN: All right. Thanks, Ryan. Good to see you again. I look forward to talking to you soon.

RYAN: Yeah, me too.

RYAN: All right, folks. There you have it. That wraps up my conversation with Ian Bond of Professional Website Investors. He shared a ton of valuable insights and advice today on how to avoid the three main risks of website investing. We also shared some tools and resources, which will all be linked up in the show notes at professionalwebsiteinvestors.com. I hope you enjoyed our conversation. Please consider subscribing, sharing with a friend, or leaving us a review in your favorite podcast directory. Until next time, best of luck in all that you do, and we look forward to seeing you on the next episode of the Professional Website Investor podcast.