Preface

Starting Anew

It was early September 2009, the first anniversary of the collapse of Lehman Brothers, which precipitated the worst economic downturn since the Great Depression. Fifteen million Americans were out of work and the economy was still shedding massive numbers of jobs each month. Millions of people owed more on their homes than they were worth and faced foreclosure. All over the country, small businesses—the engines of job creation and innovation—were starved for credit and growth capital.

Yet on Wall Street things were looking up. The S&P 500 was rebounding. After a $700 billion taxpayer-funded infusion and trillions more in emergency lending and guarantee programs, the nation's biggest banks were doing swimmingly. The top four banks emerged with an even greater share of the pie, counting 60 percent of all bank deposits between them. Goldman Sachs had recently posted the largest quarterly profit in its 140-year history, largely fueled by proprietary trading gains in a volatile market. Bonuses were back to boom levels. Morgan Stanley set aside a whopping 62 percent of its revenue to lavish on employees.

That massive disconnect between Main Street and Wall Street was starkly clear as I flew to Santa Fe to attend the inaugural national gathering of Slow Money, a Slow Food–meets-finance organization whose goal is to "bring money back down to earth." Hundreds of social investors, entrepreneurs, farmers, and citizens had assembled to see if we couldn't somehow begin to create new models for investing in local, small-scale food and agriculture enterprises—the kinds of enterprises that create things of value and help build healthy communities.

The moment was ripe with possibility. People everywhere were hungering for solutions. Although I didn't find any in Santa Fe, at least not fully formed and ready to go, the air was electric with ideas and energy. Local stock exchanges, new community-based funds, municipal bonds that would finance local food and agriculture—these were just some of the proposals being dreamed up to begin rebuilding our local economies and foodsheds. Slow Money chapters were springing up across the country, from Boston to Boulder.

As a journalist, I had covered many emerging trends that would go on to fundamentally reshape business and society: the rise of the Web, the green business and cleantech pioneers, and the growing shift toward a socially responsible way of doing business. There was something similarly significant afoot. As the country was casting about for solutions to pull us out of our economic morass, maybe the answer was right in our own backyards, in the small businesses that anchor our communities and economy.

What would the world be like if we invested 50 percent of our assets within 50 miles of where we live? Woody Tasch, the founder of Slow Money asked.

It was the most interesting question I'd heard in a while.

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This book is about alternatives.

Long before the global financial crisis exposed the flaws of our complex, intertwined, profit-at-any-cost system, a profound movement had been building that is centered on building resilient, sustainable, and healthy communities. It can be seen in the surge of "buy local" sentiment, farmers markets, and "locavore" diets.

Today, we are buying local and eating local, but we still aren't investing local. There just hasn't been an easy way for individuals to put money into worthy small businesses in need of capital.

The truth is, our financial markets have evolved to serve big business—when they serve business at all, that is. Of all the trillions of dollars madly flying through the financial markets, less than 1 percent goes to productive use, in other words, to providing capital to companies that will use it to hire, expand, or develop new products. The rest is sucked into the voracious maw of trading and speculation. And that tiny fraction of productive investment goes mainly to companies big enough to issue shares in initial or secondary public stock offerings—an increasingly exclusive club. When small enterprises create three out of every four jobs and generate half of GDP, that is not an efficient allocation of capital.

At the same time, the traditional funding sources for small businesses—savings, friends and family, venture capital, and bank credit and loans—have become mighty scarce since the financial crisis. It's more than a temporary freeze. Long-term trends—such as accelerating consolidation in the banking industry and less risk taking among venture capitalists (VCs)—do not bode well for the nation's small businesses. And decades-old securities regulations make it difficult for average investors to put money into private firms. Indeed, it's easier for most folks to invest in a corporation halfway around the world than in a small business in their own neighborhoods.

But that, I saw, was about to change. Just as "locavores" eat mostly foods that have been raised or grown in a radius of 100 miles or so, some people are now investing the same way. I call them locavestors. The idea is that, by investing in local businesses, rather than faceless conglomerates thousands of miles away, investors can earn profits while supporting their communities.

The more I looked, the more I saw the signs of a grassroots stirring. In Brooklyn, New York, where I live, residents had rallied to support two local bookstores, becoming part owners in the ventures in addition to being regular customers.

In Clare, Michigan, nine burly cops—the town's entire police force, actually—banded together to buy a 111-year-old bakery that was on the verge of closing. The renamed Cops & Doughnuts now employs 19 people and has helped revitalize downtown Clare.

In northwest Washington, the Local Investment Opportunity Network, a loose-knit group of residents, has been investing in local enterprises from bike shops to creameries. And in little Hardwick, Vermont, community financing has helped create a vibrant local food scene—and 100 jobs.

Cooperatives—businesses based on a model of democratic ownership that arose out of the dislocations of the Industrial Age—are enjoying a revival in everything from energy to food. In Wisconsin, as an epic clash between unions and a budget-slashing governor played out in the state capital, the state's rural cooperatives were demonstrating that more harmonious and productive models are possible.

As with everything, the Internet is bringing new power and reach to the idea of local investing, and social networking is broadening the concept of community. Kiva (www.kiva.org) and Kickstarter (www.kickstarter.com) have showed how the small donations of many people can have a big impact on the lives of others. Now this peer-to-peer crowdfunding model of aggregating many small sums promises to unlock new opportunities for investing in businesses whose needs are not being met by conventional sources.

Social media is also reviving the direct public offering, or DPO, a little-known method of selling shares directly to the public, without Wall Street underwriters. By cutting out expensive middlemen and lowering costs, these do-it-yourself IPOs put public offerings within reach of smaller companies and allow individual investors to get in on early stage investment opportunities typically reserved for angel investors and VCs. Ben & Jerry's raised early capital through a DPO.

Meanwhile, communities from Lancaster, Pennsylvania, to the Hawaiian islands are attempting to bring back local stock exchanges, like the ones that thrived in the United States from the 1830s until the mid-20th century, to provide liquidity and spur investment in their regional economies. Compare that to today's public markets, which facilitate speculation over investment and have all but abandoned smaller firms, and this seems like an idea whose time has come again.

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Local investing is not a panacea. Small business can be risky, and no one is suggesting that investors sink all of their money into the local farm or flower shop. Nor will local investing ever replace our global financial system. It should be viewed as a complement—and a necessary one. Without strong local economies we cannot have a healthy national economy.

But there is a very compelling case to be made for local investments as an asset class in a diversified portfolio. In a world of sprawling multinational conglomerates and complex securities disconnected from place and reality, there is something very simple and transparent about investing in a local company that you can see and touch and understand. As investing guru Peter Lynch has counseled, it makes sense to invest in what you know.

In addition to financial rewards, local investing can bring a much richer set of returns. In an age of global volatility and peak oil, a strong and varied local business base reduces vulnerability and helps make communities more self-reliant. The spending and profits generated by a locally owned company tend to stay in the area, recirculating in ways that benefit the local economy, rather than being sucked out to a distant headquarters. "Buy local" campaigns have found that a simple 10 percent shift in purchasing from chains to locally owned merchants can generate many times the amount in economic benefits. What would a similar 10 percent shift in investments yield? Or even 5 percent?

Part One of this book sets the stage for the local investing revolution. Chapter 1 details how, as a society, we are failing our small businesses, through everything from government policies that favor big business to a gross misallocation of capital. Chapter 2 explores how securities regulations have evolved to hamper local investment and how the financial industry has come to dominate our economy to a dangerous degree. Chapter 3 lays out the case for locavesting, and Chapter 4 takes a closer look at the types of companies we are talking about and why they are so vitally important to restoring balance to the economy and society.

The rest of the book is devoted to exploring various models that are emerging to reconnect local investors with local businesses. The first two chapters in Part Two deal with the traditional and most established options for investing for local impact—community banks and community development loan funds. But as you'll see, even these mainstays of small business funding face uncertain futures.

Chapters 7 through 13 explore a progressively more comprehensive range of solutions, from ad-hoc community-supported and -financed enterprises to crowdfunding to cooperatives to direct public offerings and local stock exchanges. At the end of each chapter, I've included information that will help investors who wish to more actively pursue these ideas.

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It is still early days for local investing, and if you are looking for get-rich-quick schemes this book is probably not for you. Most of these investment models have kinks that need to be worked out. Some, such as crowdfunding and local exchanges, must navigate the complex and confusing thicket of federal and state securities regulations. In all cases, a balance must be struck between facilitating the flow of capital to small, community-rooted companies and safeguarding investors from scams and unreasonable risk.

The challenges are truly daunting. But they are challenges that we, as citizens, must rise to if we want to support job growth, broadly shared prosperity, and economic independence. Isn't this the sort of financial innovation we should be encouraging? Rather than synthetic collateralized debt obligations (CDOs) and computerized robo-trading, which serve no social purpose, why not put our brainpower to work creating vehicles that allow people to invest in real companies producing real things that create real jobs?

While we will talk about investing, this book is fundamentally about fixing our broken economic system and restoring a more just and participatory form of capitalism, one that allocates capital to productive, socially beneficial use. It's about creating an alternative to the zero-sum, winner-take-all economy and the race to the bottom it engenders. It's about rebuilding our nest eggs, our communities, and, just perhaps, our country.

Indeed, there was something auspicious about the beginnings of this movement amid the financial turmoil of the last few years. As the plotters of the Slow Money insurrection gathered in Santa Fe, the city was preparing for its annual fiesta, which kicks off with a decades-old tradition known as the burning of Zozobra, or Old Man Gloom, a spectral 50-foot muslin-and-paper puppet that flails and groans. The quirky ritual was started in the 1920s by Santa Fe artist Will Schuster as a way to banish the negative memories of the past year. It attracts thousands of revelers, many of whom bring personal gloomy reminders they would like to see go up in flames. As Zozobra's roars and moans floated across the clear desert air that September evening, it was as if we were piling the CDOs, credit default swaps, and ill-gotten gains of the subprime debacle onto the pyre. It was time to start anew.