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Hawaii-based Pacific Royalties brings capital to businesses without losing equity

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Honolulu-based Pacific Royalties is offering a new way for Hawaii entrepreneurs to receive funding without losing ownership of their company.

Using a patented investment method, Pacific Royalties is establishing private investment funds that use newly-issued corporate royalties as a return on investment.

An investor can use corporate royalties to fund a company and in return annually receive a percentage of top line, pre-tax revenue. For example, after making an initial investment, an investor can receive 5 percent of revenue each year. Unlike a public offering or venture capital, no equity is given up to the investor.

"The problem with using conventional means of financing companies is that the owners — the people who make it work — end up with a less and less share of the company as the business needs additional capital," said Arthur Lipper, managing member of Pacific Royalties. "As soon as they sell any stock, they become fiduciaries obliged to make every decision based on what is best for the investor. That is in conflict in what is best for the company."

Lipper, who is based in California, also is the chairman of British Far East Holdings Ltd. and developed the patented method for managing royalty contracts. A well-known financial expert, he created the Lipper Mutual Fund Performance Analysis and stock index futures, and has served as editor and publisher of Venture Magazine.

He asks investors what is easier to predict, a trend of revenues based on a company's products and services, or specific earnings per share at a future date and time? They say revenues. In addition, because the investor does not own any of the company, he is not concerned with operations.

"There is this irreconcilable conflict between the interest of the company and the interest of the investor," Lipper said. "Royalties solve that problem because in all cases the owner and managers of the companies want higher revenues, and that's all the royalty holder cares about."

As the company becomes successful, it can acquire the royalty through a redemption clause written into the agreement, or they can negotiate with the royalty owner, Lipper said. He said Pacific Royalites suggest a 20-year term for royalties.

The technique was patented in 2010 and his investment managers have companies lined up. However, he has not committed to a company in Hawaii yet.

"Once [business owners] understand the idea, they love it," Lipper said. "But, the question is, 'Has anybody else done this?' We have a long list of people who want to be second. We are seeking those who are prepared to do something new. Nobody has found or suggested the fatal flaw, but it is a new approach which in some sense cuts out a number of the middle men in this business of financing companies."

Lipper said there are opportunities for Hawaii companies. "It depends entirely on if there are privately owned companies here for which an increase in revenues can be predicted, which wish to have additional capital," Lipper said. Companies with high-profit margins, like software or technology companies, would be good candidates, he said.

"The great opportunity in Hawaii, I believe, is to be the transition between Asia and the Mainland," Lipper said. "So there are distribution companies, there are companies that serve the Chinese market, serve the Asian market, that could be located here, and some of them could offer services."

In addition, Pacific Royalties doesn't need a home-run investment to make money, as is the case with the high-risk, high-reward nature of venture capital.

"There's so many good companies here — solid people, good products, good business model, established track record - and they grow bit by little, painful bit over the years," said Michael North, the Honolulu-based managing member of Pacific Royalties. "They make a little profit, they reinvest it, they borrow some money from their aunts and uncles, maybe they get a line of credit.

"But they never really hit their potential because they can never get that big shot of capital to open up China as a market, acquire a competitor or license a new technology that's really going to put them on a world stage," he said. "That's what royalties are designed to do."

Lipper also thinks that there will be more royalty income funds and exchanges which will trade royalties as though they were securities, and that there will more companies using royalties than publicly traded companies.

"I think that's inevitable because the royalty is a logical means of meeting the needs of both the business owner and the investor," Lipper said.

Jason Ubay covers tourism and finance for Pacific Business News.