



From 'dude' to dividends: the budding industrialization of pot

By: Martha C. White – June 5, 2013

The pot industry isn't being cultivated with grow lights behind blacked-out windows anymore. Despite federal drug-enforcement and tax laws that render it illegal — and hard to turn a profit as a mainstream business — the economics of pot are becoming closer to what one advocate dubs “Big Marijuana.”

“It's been an industry for a long, long time. It's just been an underground industry,” said Jeffrey A. Miron, a senior fellow at the Cato Institute and senior lecturer in economics at Harvard University.

Pot has a trade association, and is planning its third annual lobbying day in Washington, D.C., for this week, signaling that the industry is growing up, said Betty Aldworth, deputy director of the National Cannabis Industry Association.

“The most interesting thing about what's happening to the marijuana marketplace right now is it's moving from the underground to essentially being just any other commodity that's sold in a regulated market,” she said. “So you're going to see the same kind of business and political functions that happen with any other product.”

And it's not just the activists taking an interest: Hedge funds and venture capitalists are starting to see the potential pot offers as a business opportunity in spite of occupying a legal gray area.

Private equity and venture capitalists bring expertise raising money, making money and lobbying for the interests of their business in the political arena, said Ethan Nadelmann, executive director of The Drug Policy Alliance. “More and more of the players ...are coming out of the hedge fund world, the real estate world,” he said, and applying the same skills they've used to grow other industries.

“This experiment in democracy that's taking place in Washington and Colorado is going to continue to evolve in other states... it's just a matter of time and waiting for the federal government and bureaucrats and politicians to catch up to the changing tide of American public opinion,” predicted Brendan Kennedy, CEO of private-equity firm Privateer Holdings, which focuses on the marijuana industry.

“It's a mainstream product and our investors see that, and they also see it's inevitable that it will be legalized and it's inevitable that there will be a real industry,” Kennedy said.

There is a broader cultural shift under way. Americans' attitudes about marijuana are changing, a survey published last month by the Pew Research Center for the People and the Press found. For the first time, a majority of Americans support legalizing pot. Half of Baby Boomers and roughly two-thirds of millennials say marijuana should be legalized, and just under half of Americans say they've tried it.

"You do have a lot of people saying the genie's out of the bottle despite what the federal government does," said Chris Walsh, editor of Medical Marijuana Business Daily.

Professional investment capital means the industry can shed 'stoner' stereotypes and tie-dye clichés, Kennedy said, and start implementing quality standards, cohesive marketing and branding strategies and industry-wide leadership.

"It's still an industry that's remarkably young," Kennedy said. Pot is a fragmented, decentralized business with very little standardization — not unexpected, in a field where entrepreneurs can get their start palming baggies at music festivals.

Former Microsoft executive Jamen Shively wants to turn pot into a national, branded commodity in one fell swoop. Last Thursday, Shively held a news conference in Seattle, accompanied by former Mexican President Vicente Fox, to announce that he is raising \$10 million in start-up capital to build a chain of retail marijuana stores, a down payment on what he said would be a \$100 million investment in three years.

"Yes, we are Big Marijuana," Shively said. He outlined a plan to build a national brand of retail marijuana stores, which would be supplied by regulated trade with Mexico.

If Shively found pot's illegal status to be a bit of a buzzkill, he didn't show it. "We believe the writing is on the wall that marijuana will become legal in the entirety of the U.S. in the next decade or so," says the website of Shively's firm, Diego Pellicer.

Shively's announcement came two days after Colorado's recreational-use legislation officially became law. As voters in more states pass referendums legalizing medicinal and, less commonly, recreational pot use, states are interested in the revenue potential that could come from legalizing and taxing marijuana.

A report published last month by the Colorado Futures Center at Colorado State University said recreational pot use in the state is a \$605.7 million market that will generate \$130.1 million in state tax dollars for fiscal year 2014-15.

In 2010, Miron estimated that, nationwide, pot could generate \$8.7 billion in federal and state tax money annually if it were taxed like other "vice" products such as alcohol and tobacco.

But he is skeptical that Big Marijuana is on the horizon in the immediate future. "I think a lot of people are putting the cart before the horse," Miron said. "It's still an illegal commodity."

Starting a pot business even in states where it's legal is an uphill battle. Aldworth said 1980s-era tax code legislation prevents marijuana dispensaries, even in states where they operate legally, from being able to deduct many of the standard expenses other small

businesses can. And since banks or credit unions generally won't work with them, pot businesses are cash operations, without the access to financing sources other businesses take for granted.

Pot might have been the catalyst behind Harold and Kumar's fateful trip to White Castle, but when it comes to making pot as ubiquitous as fast food, "It's going to be a lot harder than some people make it sound," Walsh said.

"It will really depend how the federal government responds," he said.

But even if early efforts like Shively's fail to bear fruit, Walsh said, "This is a good thing for the industry." It attracts the interest of the investment community, and "it is starting the conversation," he said. "People have been talking about a tipping point for years. They could be right this time."