Coninued from The Stock Market, Part One…

Prior to the road show, we put together an amazing presentation. We hired consultants to help us. We practiced and practiced. We argued about what we should and shouldn't say. We had Morgan Stanley and others ask us every possible question they could think of so we wouldn't look stupid when we sat in front of these savvy investors.

Savvy investors? I was shocked. Of the 63 companies and 400-plus participants we visited, I would be exaggerating if I said we got 10 good questions about our business and how it worked. The vast majority of people in the meetings had no clue who we were or what we did. They just knew that there were a lot of people talking about the company and they should be there.

The lack of knowledge at the meetings got to be such a joke between Todd and I that we used to purposely mess up to see if anyone noticed. Or we would have pet lines that we would make up to crack each other up. Did we ruin our chance for the IPO? Was our product so complicated that no one got it and as a result no one bought the stock? Hell no. They might not have had a clue, but that didn't stop them from buying the stock. We batted 1.000. Every single investor we talked to placed the maximum order allowable for the stock.

On July 18, 1998, Broadcast.com went public as BCST, priced at 18 dollars a share. It closed at $62.75, a gain of almost 250 percent, which at the time was the largest one day rise of a new offering in the history of the stock market. The same mutual fund managers who were completely clueless about our company placed multimillion orders for our stock. Multimillion dollar orders using YOUR MONEY.

If the value of a stock is what people will pay for it, then Broadcast.com was fairly valued. We were able to work with Morgan Stanley to create volume around the stock. Volume creates demand. Stocks don't go up because companies do well or do poorly. Stocks go up and down depending on supply and demand. If a stock is marketed well enough to create more demand from buyers than there are sellers, the stock will go up. What about fundamentals? Fundamentals is a word invented by sellers to find buyers.

Price-earnings ratios, price-sales, the present value of future cash flows, pick one. Fundamentals are merely metrics created to help stockbrokers sell stocks, and to give buyers reassurance when buying stocks. Even how profits are calculated is manipulated to give confidence to buyers.

I get asked every day to invest in private companies. I always ask the same couple questions. How soon till I get my money back, and how much cash can I make from the investment? I never ask what the PE ratio will be, what the Price to Sales ratio will be. Most private investors are the same way. Heck, in Junior Achievement we were taught to return money to our investors. For some reason, as Alex points out in The Number, buyers of stocks have lost sight of the value of companies paying them cash for their investment. In today's markets, cash isn't earned by holding a company and collecting dividends. It's earned by convincing someone to buy your stock from you.

If you really think of it, when a stock doesn't pay dividends, there really isn't a whole lot of difference between a share of stock and a baseball card.

If you put your Mickey Mantle rookie card on your desk, and a share of your favorite non-dividend paying stock next to it, and let it sit there for 20 years. After 20 years you would still just have two pieces of paper sitting on your desk.

The difference in value would come from how well they were marketed. If there were millions of stockbrokers selling baseball cards, if there were financial television channels dedicated to covering the value of baseball cards with a ticker of baseball card prices streaming at the bottom, if the fund industry spent billions to tell you to buy and hold baseball cards, I am willing to bet we would talk about the fundamentals of baseball cards instead of stocks.

I know that sounds crazy, but the stock market has gone from a place where investors actually own part of a company and have a say in their management, to a market designed to enrich insiders by allowing them to sell shares they buy cheaply through options. Companies continuously issue new shares to their managers without asking their existing shareholders. Those managers then leak that stock to the market a little at a time. It's unlimited dilution of existing shareholders' stakes, death by a thousand dilutive cuts. If that isn't a scam, I don't know what is. Individual shareholders have nothing but the chance to sell it to the next sucker. A mutual fund buys one million shares of a company with your and your coworkers' money. You own 1 percent of the company. Six weeks later you own less, and all that money went to insiders, not to the company. And no one asked your permission, and you didn't know you got diluted or by how much till 90 days after the fact if that soon.

When Broadcast.com went public, we raised a lot of money that certainly helped us grow as a company. But once you get past the raising capital part of the market, the stock market becomes not only inefficient, but as close to a Ponzi scheme as you can get.

As a public company, we got calls every day from people who owned Broadcast.com stock or had bought it for their funds. They didn't call because they were confused during our road show, were too embarrassed to ask questions and wanted to get more information. They called because they wanted to know if the "fundamentals" – the marketing points – they had heard before were improving. And the most important fundamental was "The Number," our quarterly earnings (or in our case, a loss). Once we went public, Morgan Stanley published a report on our company, as did several other firms. They all projected our quarterly sales and earnings. Would we beat The Number?

Of course, by law, we were not allowed to say anything. That didn't stop people from asking. They needed us to beat the forecast. They knew if we beat The Number the volume on the stock would go up. Brokers would tell their clients about it. The Wall Street Journal would write about it. CNBC would shout the good news to day traders and investment banks that watched their network all day long. All the volume would drive up the stock price.

Unfortunately, patience is not a virtue on Wall Street. Every day, portfolios are valued by at closing price. If the value of your fund isn't keeping up with the indexes or your competition, the new money coming in the market won't come to you. It just wasn't feasible for these investors to wait till the number was reported by companies each quarter. The volume had to be on the stocks in you fund. To keep the volume about a stock up, and the demand for the stock increasing, you needed to have good news to tell.

Volume, The Number, whisper numbers, insiders granting themselves millions and millions of options these are the games that Wall Street plays to keep on enriching themselves at the expense of the public. I know
this. I have tried to tell people to be careful before they turned over their life savings and their financial future to someone whose first job is to keep their job, not make you money.

Till I read The Number by Alex Berenson, I never had a book that explained how the market truly worked that I could tell my friends, family and acquaintances to read. I never had a book that would truly warn them that the market was not as fair and honest as mutual fund and brokerage commercials made them out to be. I may be a cynic when it comes to the stock market, but I am an informed cynic, and that has helped me make some very, very profitable decisions in the market.

If you are considering investing in the market, any part of it, or if you are considering giving your hard earned money over to someone else to manage, please, please read The Number first.

Mark Cuban, Dallas, Texas, January 2004