Jumpstarting Growth

The JOBS Act promotes investments in small businesses

By Jack Garson

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On April 5, 2012, the president signed into law the new Jumpstart Our Business Start-ups Act. The primary purpose of the JOBS Act is to reduce the legal burdens that small businesses face in raising capital.

With this new law, the pendulum has now swung once again toward deregulation, and rather quickly at that. In the wake of the Enron scandal and, later, the financial meltdown on Wall Street in 2008, Congress passed a variety of restrictions on the financial world. First, the Sarbanes-Oxley Act and then the Dodd-Frank Act imposed new regulations, including burdensome disclosure requirements for publicly traded companies. These laws were layered on top of the securities acts passed in the 1930s, largely as a consequence of another couple of economic boo-boos: the stock market crash of 1929 and the Great Depression.

To understand the significance of the JOBS Act, you first need to realize the impact in time, effort and expense imposed by current laws that regulate investing in businesses. In a nutshell, to sell stock in your company to the public ("going public") you must register with the government unless you are exempt. The registration requirements are extremely burdensome. For example, the registration process requires that you produce and disclose years of detailed financial statements that are "blessed" (not the technical term) by specialized accountants who have determined you pass intricate standards, such as special internal controls on your financial systems. In addition, applicable law restricts when and how you can raise money. For example, you are limited in what you can say about your company to possible investors before the government has approved the materials you want to provide to the public. Then, for so long as you remain a publicly owned company, you must continue to provide detailed information to the government, your investors and the public. If you are thinking this is expensive and a supreme hassle you're right.

There are exemptions from these registration requirements. But to take advantage of these legal loopholes, you are restricted in a variety of ways. Generally, the amount of money you can raise is capped. Then, for the most part, you can only obtain this money from relatively wealthy people. Further, you can only get these funds from a limited number of investors.

If you violate the registration or exemption rules, you can be barred from raising money or, for minor infractions, substantially delayed. Also, you may be subject to severe civil and criminal penalties for significant violations. So you need an expensive team of experts and a lot of time and preparation to raise money for your company from investors. The JOBS Act reduces these fundraising burdens for smaller companies.

Join the Crowd

In one of the more novel features of the new law, the JOBS Act provides a new exemption from certain securities registration requirements for "crowdfunding." Crowdfunding is the new "pass the plate" of the internet world. Until recently, the only legal crowdfunding in the United States largely consisted of donations, usually made via the internet and sometimes in exchange for small gifts, often solicited for creative projects by musicians, filmmakers, and journalists. A thousand people would each chip in 10 bucks to sponsor a concert tour or the production of a documentary. But with the JOBS Act, small U.S. businesses will be able to raise money through crowdfunding. Companies must use special, regulated brokers or portals that comply with requirements of the new law. But by using these qualified intermediaries, small businesses can raise up to $1 million total. Limitations apply on the amount that can be raised from any one investor. There is a net-worth test applicable to investors. However, the threshold is relatively low compared to prior legal requirements. Depending on the net worth of the investor, a business can raise anywhere from $2,000 to $100,000 per investor. Other fine print requirements apply. But for those businesses seeking critical start-up funds and especially those with crowd-pleasing business ventures crowdfunding may provide a source of investments with far less expense and documentation.

Emerging Growth Companies

One of the most significant features of the JOBS Act is the creation of a new category of business that will be exempt from many existing legal requirements applicable to companies that go public. The act defines an "emerging growth company" (EGC) as a business that had not completed its initial public offer of stock on or before December 8, 2011, and had less than $1 billion in total annual gross revenues in its most recent fiscal year. You lose your EGC status after you exceed $1 billion in gross revenues or approximately five years after you go public and under a few other circumstances. But in the meantime, you enjoy considerable benefits. These perks include:

- Exemption from certain auditing requirements.
- Reduced financial disclosure requirements.
- Increased ability to communicate with certain potential investors.
- Relaxed restrictions on research analysts publishing research about your company.

There is some concern that potential investors will be skeptical about investing in EGCs, due to the relaxed requirements. But for the right companies, the JOBS Act may reduce costs and other regulatory burdens enough to enable them to raise critical capital from the public.

More Shareholders, Less Registration

Before the enactment of the JOBS Act, one exemption from federal securities law generally required companies to register with the government when they reached 500 or more investors and total assets exceeding $10 million. While the $10 million cap remains in place, under the act, most companies using this exemption won't have to register until they have a headcount of 2,000 investors or 500 non-accredited investors (accredited investors are certain organizations, as well as people with a high net worth or substantial income). The act also excludes employees receiving stock (pursuant to an employment compensation plan) from the investor headcount limit under this exemption. Notably, the act further maintains a legal loophole that potentially allows companies to raise money from far more investors under this exemption.

Other Fundraising Boosters

The act contains other features that could boost investments in small companies. The JOBS Act increases one exemption from stock registration requirements so companies will be able to raise $50 million, up from $5 million, in a 12-month period. The act eliminates certain existing limits on advertising and other general solicitations that have frustrated companies' ability to communicate with potential investors.

There is concern that the reduced requirements of the JOBS Act will undo necessary protection of the investing public. Eventually, we'll find out if that's the case. But in the meantime, this new law may provide the opportunity for many small businesses to raise much-needed capital in new ways and under significantly reduced requirements. As always, consult with professional advisers before trying any of this at home.

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