Has the JOBS Act of 2012 Helped Startups?

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Executive Summary

- While many have celebrated the reduction in regulation of small businesses as a result of the Jumpstart Our Business Startups (JOBS) Act of 2012, others have criticized the act for not going far enough to support small businesses.
- Although a major intent of the act was to reduce the costs for Emerging Growth Companies (EGCs) to conduct an initial public offering (IPO), research on the effectiveness of this goal is mixed.
- The JOBS Act enabled the new use of crowdfunding and other alternative means to raise funding, though the Regulation R private placement mechanism is still the most common method.
- Policymakers and academics need to work together to determine the overall impact of the JOBS Act of 2012 on job creation, innovation and entrepreneurship.

Major Provisions of the JOBS Act of 2012

At the 2020 Kenan Institute Frontiers of Entrepreneurship conference, a group of expert panelists gathered to discuss how the Jumpstart Our Business Startups (JOBS) Act of 2012 may have helped start-ups. The JOBS Act created unprecedented opportunities for small businesses to raise capital. Among other things, the act lifted the ban on general solicitation, enabled equity crowdfunding and increased limits on the shareholders of record in private companies. Many of these changes were intended to reduce regulation and enable alternative means of raising capital. For example, up to $1.07 million can now be raised through equity crowdfunding every 12 months; general solicitation can occur through television, the internet and other means; and the IPO requirements for emerging growth companies (EGCs), such as removing the requirement to provide auditor attestation under the Sarbanes Oxley (SOX) Act of 2002, have been relaxed.

Has the Act Reduced Regulatory Costs?

These efforts to reduce regulatory costs have not gone unnoticed by EGCs. Greg Weaver, CFO of Eloxx Pharmaceuticals, gave a clear example of how the JOBS Act changes influenced his company. Weaver explained that most biotech companies are pre-revenue, and thus must raise significant capital in order to develop drugs over a 10- to 15-year period. The exemption from SOX 404(b) auditor attestation requirements enabled Eloxx to save roughly $800,000 a year in compliance costs. Weaver explained that, since biotech EGCs increase employment on average by 178 percent during the five years after an IPO, the decreased regulations from the JOBS Act acted as a large boon for job growth.

While individual accounts such as these are encouraging, academic research on the topic has been mixed. Some studies have shown that market reactions for EGCs have been significantly positive,[1] while others have shown that the JOBS Act has increased underpricing[2] and actually increased audit fees among EGCs.[3]

How Has the Act Enabled Greater Use of Crowdfunding?

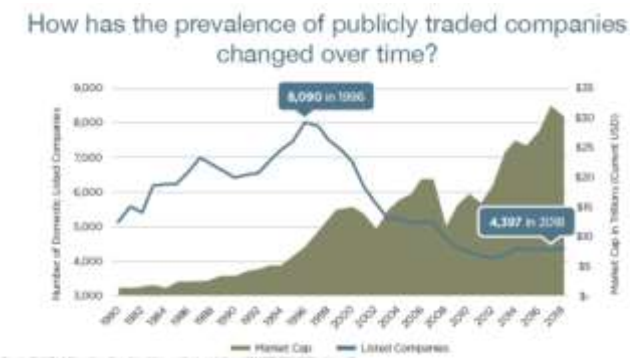
Source: Annual Report of 2019, Office of the Advocate form Small Business Capital Formation

Beyond reducing regulatory costs, the JOBS Act also opened up a number of new avenues by which small companies can raise capital. The most popular element of the law is Title III, typically referred to as the CROWDFUND Act.

This provision enables companies to use crowdfunding to issue securities, something previously prohibited. While numerous articles point to the potential benefits of crowdfunding, new data from the Security and Exchange Commission's Office of the Advocate for Small Business Capital Formation shows that the use of crowdfunding to raise capital remains limited compared to traditional private placements and public offerings. As Figure 1 illustrates, the most common form of private offering remains private placements through Rule 506(b), a provision that was in place before the JOBS Act of 2012.

What Changes Might Augment the Effectiveness of the JOBS Act?

When asked about ways to increase the effectiveness of the JOBS Act of 2012, a number of key suggestions were given. Martha Legg Miller, director of the U.S. Securities and Exchange Commission's Office of the Advocate for Small Business Capital Formation, noted that her office was created by the SEC to help small businesses raise capital. Legg Miller shared that a major reason for this new focus is the changing nature of publicly traded companies. From 1996 to 2018, the number of traded companies in the U.S. has dropped from 8,090 to 4,397. Yet the market cap of these companies has grown from roughly $5 trillion to more than $30 trillion in the same time frame. More small businesses need to become aware of the ways that the JOBS Act can help them, said Legg Miller, which she and her office are working to address.



Source: Annual Report of 2019, Office of the Advocate form Small Business Capital Formation

Panelist Kevin Laws, CEO of AngelList, made a suggestion that he thinks will enable greater funding of early-stage entrepreneurs. "One of the things I want to see changed," he said, "is to allow more secondary options for early angel investors." According to Laws, successful angel investors have their capital locked up for decades. Because 50 percent of these investors' returns go back into new startups, enabling more liquidity would result in further entrepreneurial investment.

Panelist Michael Piwowar, executive director of the Milken Institute Center for Financial Markets, encouraged academics to research the efficacy of the JOBS Act in order to garner further insights about ways to improve the act.

Policy Takeaways

- Additional research on the effectiveness of the JOBS Act of 2012 to create jobs, spur entrepreneurship and increase innovation is needed.
- Increasing secondary options for angel investors would allow more capital to flow back to early-stage entrepreneurs, as angel investors often have capital locked up for decades.

- Helping small companies learn about the SEC's new Office of the Advocate for Small Business Capital Formation, designed to help small businesses grow and raise capital, will help more entrepreneurs understand how key provisions of the JOBS Act can help them.

Contributing Experts

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Michael Piwowar, Executive Director, *Milken Institute Center for Financial Markets*
Greg Weaver, CFO, *Eloxx Pharmaceuticals*

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