Raising capital

How the JOBS Act has created funding opportunities for small businesses

INTERVIEWED BY ROGER VOZAR

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The JOBS Act, passed in 2012, changed rules to make it easier for small businesses to secure funding from investors.

"The Securities and Exchange Commission actually has three initiatives related to the JOBS Act. Crowdfunding has received most of the attention, but the SEC also amended Regulation D to allow small businesses to use general advertising and offers the Regulation A option, which is sort of a mini registration," says James S. Hogg, a partner at Brouse McDowell.

Smart Business spoke with Hogg about how these JOBS Act options work and what they offer small businesses looking to raise funds.

What has changed with the amendment to Regulation D?

In the past, a private placement had to be done without general advertising, so you would either use a broker to find wealthy investors or you would find them; it was more or less word of mouth. Once you found investors, you would do a conventional private placement.

According to the SEC, $900 billion was raised that way in 2012. Of that, about $8 billion was raised in offerings of less than $5 million each. The amended regulations are intended to allow more small businesses to participate by expanding the pool of investors they can reach. But when you use general solicitation — Internet, newspapers, radio — you can only sell to accredited investors and there are more rigorous procedures to follow to ensure buyers are accredited.

To be accredited, an investor must have a net worth of $1 million or annual income of $200,000. You can still raise funds the old way under Regulation D, which allows for up to 35 non-accredited investors and an unlimited number of accredited investors. But if you use general solicitation, all investors must be accredited.

How can small businesses use crowdfunding?

Nothing is set until the SEC adopts final rules, but based on the proposal, companies are limited to raising $1 million in a 12-month period.

Crowdfunding has hit a couple of snags. One involves regulation; the proposal doesn't allow for state regulation and some regulators would like to see more safeguards, while other people want to get money to small businesses as quickly as possible.

The SEC proposal requires use of a funding portal such as Kickstarter or Indiegogo and limits purchasers — a person with net worth of less than $100,000 can't spend more than $2,000 or 5 percent of their net worth a year, and someone with a net worth of more than $100,000 is restricted to 10 percent of their net worth.

Crowdfunding would also require annual reports, although they would be basic — including financial statements that may have to be reviewed by a CPA firm, and if the amount raised was more than $500,000, you would also need an audit. As proposed, the rules might make crowdfunding unattractive. I'm sure that's part of the comments the SEC is wrestling with.

What is happening with Regulation A offerings?

Historically, if you did a Regulation A offering, which is like a mini registration, it would not be given an exemption from state registration. As a result, only 0.2 percent of offerings under $5 million used Regulation A.

The SEC has made it a two-tier system by adding a new rule that allows an exemption from state securities law registration. You can still raise money the old way, but if you elect to do so under the new rule, there are reporting requirements in return for the state law exemption. The maximum amount that can be raised would also increase from $5 million to $50 million.

This is still in the proposal stage, and comments are being accepted through March 24.

How do businesses decide what route to take?

If you're really small and raising funds entirely in Ohio, you can sell to up to 10 investors without any filings, but make sure you meet the requirements for this exemption. Most companies with larger offerings will probably continue to opt for Regulation D, but when the regulations are finalized they may consider crowdfunding or Regulation A if those are exempt from state securities registration. ●