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Long-term Investors Raise Concerns over JOBS Act Market Effects

By Myriam Denis, J.D. Candidate 2016 | October 16, 2014

It has been a little over two years since Congress passed the Jumpstart Our Business Startups Act ("JOBS Act"), modifying certain securities regulations to make it easier for companies with less than $1 billion of total gross revenue – emerging growth companies ("EGCs") – to pursue initial public offerings ("IPOs") and gain access to capital on the market. Under Title 1, EGCs covered by the JOBS Act only have to release two years of audited financial statements (instead of the standard three), disclose the pay packages of their three top-paid executives (instead of the standard five), initiate the IPO process confidentially and are exempt from the internal controls audit required by Section 404(b) of the Sarbanes-Oxley Act.

It is admittedly hard to evaluate the impact of the JOBS Act on the IPO market, due to external factors that come into play, but various studies seem to point toward positive short-term effects. Numbers compiled by Bloomberg show the number of initial public offerings in 2013 were the highest since 2007. Also, according to a study by Latham & Watkins, nine out of ten IPOs are issued by EGCs. EGCs are strongly taking advantage of the changes made available to them – for instance, according to a study by Skadden, 87% of EGC IPOs consummated in 2013 availed themselves of the confidential submission process. This includes companies such as Twitter and GoPro Inc.

The JOBS Act has without a doubt given a positive push to small businesses and short-term investors, but some long-term investors are now starting to worry about some of the side effects. Some commentators are afraid the Act could mean that EGCs start off with a rising stock price, only to sharply go down within a year.

As detailed in a Wall Street Journal blog post by Emily Chasan, last year's larger IPOs have posted average gains of 40%, while those of EGCs are hovering around 36% - the same pattern as before the JOBS Act. Among other things, her post argues that the benefits provided by the JOBS Act make it tougher to evaluate company practices, such as executive-pay practices, which ultimately harm long-term returns.

Jacqueline Urban, practice leader at Aon Risk Solutions financial services group, raises another relevant point to this issue: EGCs launching an IPO under the JOBS Act rules without following required procedures may be susceptible to improper/inadequate disclosure litigation. Carl E. Metzger, partner at Goodwin Procter LLP in Boston, stated, "the altered landscape as a result of the JOBS Act could lead to additional ways in which plaintiff lawyers try to attack companies that benefited [from the Act]."

The JOBS Act remains a relatively recent piece of legislation, and it's still too early to fully analyze its effects – both short-term and long-term – on investments. One thing is certain: a bill prompting so many important changes in a vital sector of the economy will have significant consequences.