

BARRON'S

Daily

Loosening the Rules for Small Stock Offerings Hurt Investors: Study

Bill Alpert

760 words

21 April 2022

16:30

Barron's Online

BON

English

Copyright 2022 Dow Jones & Company, Inc. All Rights Reserved.

This month marks the 10th anniversary of a law that relaxed rules for small stock offerings. Whether the loosening that resulted from the Jobs Act of 2012 was a good thing depends on whom you talk to.

Republican congressmen gathered recently with some stock issuers to laud the reform. Meanwhile, a study by two accounting professors found that investors who bought these small stock offerings lagged behind the broader market.

At an [April 5 roundtable](#) celebrating the IPO reforms, Republican members of the House Financial Services Committee noted the boom in small stock offerings that followed the 2012 law's relaxation of the Securities and Exchange Commission's Regulation A. The committee's top Republican, Patrick McHenry of North Carolina, proposed further loosening IPO rules, in what he and his colleagues called a Jobs Act 4.0.

By reducing disclosure requirements and allowing crowdfunding by "Main Street" investors, said [a report by committee Republicans](#), the Jobs Act of 2012 revived the market for initial public offerings and let everyday consumers "get in early with tomorrow's success stories."

[A study of 582 of the deals](#) published this week by accounting professors at the UC Berkeley Haas School of Business found otherwise. It concluded public investors who bought and held these Reg A stocks underperformed the decade's roaring bull market. Politicians may celebrate the large number of firms that came public under the law's relaxed burdens, says the Haas School's Panos Patatoukas, "but this myopic focus on quantity, without thinking about quality, had bad consequences for the savings of everyday investors."

The Haas study will appear in the [Critical Finance Review](#). It notes that prior research on the IPO reforms failed to account for the bull market that was taking off just as the law took effect. In essence, boosters of the offerings were confusing investment savvy with a rising market for nearly every equity.

IPOs had dried up in years after the 2007-09 financial crisis, so there was strong bipartisan support in 2012 when President Barack Obama signed the loosening laws that allowed less-seasoned issuers to market their stock to small investors, while disclosing less financial information. Hundreds of stock issuers subsequently took advantage of liberalized IPO rules available to "emerging growth companies."

Looking at the years before and after the rule change, Patatoukas and his co-authors, Omri Even-Tov and Young Yoon, compared the IPO performance of emerging growth companies against those of larger firms still bound by the usual IPO rules. The researchers found that the Jobs Act issuers sold their stock at significantly higher valuation multiples than other firms, "even though they have more speculative valuation profiles and are more likely to destroy long-term shareholder value for IPO aftermarket investors."

A 2018 Barron's [investigation of Reg A offerings](#) found a low level of quality in many of those deals, with the most prominent one later [alleged to be a fraud](#) by the SEC.

Barron's queried Rep. McHenry about the Haas study findings, but got no response. In congressional hearings, McHenry has frequently said that small investors are smart enough to tell the good deals from the bad.

The Haas professors made a close inspection of issuers that took advantage of the reduced accounting disclosures allowed under the 2012 law. The small companies could present just two years of audited financial statements and selected financial data, rather than the previously required three years of audited statements and five years of selected financials. Even when companies had at least three years of operations, the study found that half chose to show just two years of numbers.

Investors seem to have paid the price for these curtailed disclosures. Among the firms that chose reduced-accounting disclosure, 66% underperformed the market in the three years after their IPOs, compared with 49% of those giving a full accounting.

Rather than further loosen IPO rules—as the Republican congressmen proposed in their report this month—the Haas accounting professors urge regulators to go back to requiring three years' of financial disclosures.

Protecting investors in these small IPOs is even more important now than 10 years ago, says Patatoukas, because of the flood of small traders buying new issues on apps like Robinhood Markets (ticker: HOOD). "They have easy access to trading," says the professor, "but not to informed investment decision-making."

Write to Bill Alpert at william.alpert@barrons.com

[Loosening the Rules for Small Stock Offerings Hurt Investors: Study](#)

Document BON0000020220421ei4I000m9