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responsibility to facilitate capital formation with our obligation to protect investors ...

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It's called the "Jumpstart our Business Startups Act"—the JOBS Act for short, enacted by Congress five years ago in the hope of spurring job creation by easing the process by which relatively small companies make initial public offerings (IPOs). The law created a category of so-called "emerging growth companies" (EGCs), defined as IPO-issuing firms that have less than $1 billion in revenues in the year prior to the offering. Prominent among the benefits the law bestows on EGCs is a substantial reduction in the public disclosures these firms are required to make about their finances and operations.

Though passed with strong bipartisan majorities, the bill drew a cautionary letter to Congress from the SEC chairman at the time, Mary Schapiro. Contrasting "our responsibility to facilitate capital formation with our obligation to protect investors and markets," the chairman warned against "the balance [being] tipped to the point where investors are not confident that there are appropriate protections."

Now some new research validates this concern.

A paper in the forthcoming issue of ***The Accounting Review***, a journal of the **American Accounting Association**, compares the initial public offerings of EGCs with those of non-EGCs (NEGCs) – firms that would have been EGCs had their IPOs occurred after the passage of the JOBS Act. The study – by Mary E. Barth of Stanford University, Wayne R. Landsman of the University of North Carolina at Chapel Hill, and Daniel J. Taylor of the University of Pennsylvania's Wharton School – finds considerably greater underpricing and volatility in the shares of the EGCs than in those of the NEGCs in the wake of their respective IPOs.

Underpricing is, in effect, money left on the table for investors who purchase shares

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difference between the initial offering price and the price at day's end) was on average about 55% greater than the underpricing of NEGC shares, and at 30 business days post-IPO it was over 100% greater. At this point the difference in underpricing between the average EGC and the average NEGC amounted to a hefty 13% of IPO proceeds.

Comments Wharton's Prof Taylor: "That's a lot of dollars left on the table by virtue of the JOBS Act, money that issuing companies could otherwise have collected at the IPOs. This would hardly seem to be in the interest of shareholders. At a time when the SEC is considering extending the Act's disclosure reductions to all publicly traded firms, our findings certainly raise questions about doing so, notwithstanding current corporate complaints about burdensome disclosure requirements."

In testimony this September before the Senate Banking Committee, the SEC's recently appointed chairman, Jay Clayton, stated that "the Commission will soon consider a proposal…to modernize and simplify the disclosure requirements…in a manner that reduces costs and burdens on companies while still providing for the disclosure of all required material information." Prof. Taylor asks: "Does reducing the disclosure burden for companies mean sacrificing investor protections? The evidence we find in the case of the JOBS Act suggests that it does."

The new research, which represents the most extensive analysis to date of the JOBS Act's disclosure-reduction provisions, is based on data from all IPOs in the U.S. between July 1, 2009 (about 33 months before the JOBS Act's passage) and December 31, 2013 (about 21 months after its passage). The sample consists of 376 firms, 158 of which were EGCs (their IPOs occurred post-JOBS Act) and 218 of which were NEGCs (IPOs occurring pre-JOBS Act). Firms had mean assets of about $380 million and mean revenues in the year prior to their IPOs of about $150 million.

In addition to finding greater underpricing and volatility among EGCs, the

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between reduced financial statement disclosure and underpricing.

Why would corporate managers want to withhold compensation information, even if it increases the amount of IPO proceeds left on the table? While the study does not provide a definitive answer, the authors note that "the reduction in IPO disclosures could reflect an information-based agency problem whereby managers personally benefit at the expense of shareholders – e.g., opportunistically eliminating disclosure to hide poor performance or details of an excessive pay package...Hence, greater underpricing for EGC firms might reflect not only heightened uncertainty arising from poor disclosure but also deadweight losses arising from agency problems."

In other words, the reduced corporate disclosure that the JOBS Act allows can mean double trouble for investors: the legislation not only creates the potential to conceal mismanagement and misfeasance but, through the uncertainty engendered by that potential, deprives companies and their shareholders of IPO proceeds they might otherwise enjoy.

These drawbacks notwithstanding, has the JOBS Act fulfilled hopes for an increase in the number of IPOs and concomitant growth in the economy and jobs? Studies offer mixed answers, but, when the question is posed to Prof. Taylor, he readily acknowledges that evidence suggests the number of IPOs has increased since the law's passage. A more important issue, he says, is not the *quantity* of companies going public but their *quality*. "Is it better to have 100 companies that each raises $50 million or 75 companies that each raises $100 million?" he asks.

The professor draws an analogy with the used-car business.

"Suppose that before selling a used car everyone is required to disclose the detailed history of its performance. Because buyers can see the past performance, they can avoid purchasing lemons. If disclosures are optional, the number of cars for sale may increase, but buyer beware.

“The net effect may be to attract more mechanics as customers, because they’ll be

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