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JOBS Act Confined by Limited Reach

For most companies, Titles II and III of the JOBS Act won't be of much aid in raising substantial capital or attracting investors.

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The JOBS Act was crafted with the hopes of making it easier for companies of all sizes to access funding by loosening regulations and expanding the investor pool. While Title I of the act saw success in increasing IPOs by lowering the hurdles for emerging companies to go public, Titles II and III seem to be facing more challenges. Simply put: Title II doesn't bring in enough new investors, and Title III doesn't bring in enough new money.

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Title II: Small Audience

Title II went into effect Sept. 23, 2013, and allows for the general solicitation of accredited investors (annual income of $200,000 or net worth of at least $1 million, excluding a personal residence). The law allows organizations to advertise their fundraising efforts, making it easier for private companies to reach potential investors.

The ability to market a capital raise online, particularly through social media, adds transparency and streamlines the process of collecting capital. But with the Securities and Exchange Commission's estimate of 8.7 million accredited investors and only 3% of those interested in actively participating, the target audience for these solicitations is inherently limited and I don't think it will bring major changes.

That's not to say that Title II is a complete loss. There were more than 6,000 offerings under Title II in the first two years, according to a 2015Crowdnetic report. That may seem like a small number, but when you consider the segment of the audience that is actively investing out of the accredited investor population, it sounds more successful.

In my experience, the sector that has benefited the most is real estate. Everyone seems to have a thesis as to what investment projects have more upside than others, and real property is a tangible asset that is much easier to research and understand than a new tech startup or obscure business venture. Accredited investors often seek out commercial and residential real estate opportunities to diversify their portfolios. With Title II allowing new communication tools such as social media and websites to market these opportunities, investors don't need personal connections to get in on a deal.

Title III: Limited Capital

Title III is perhaps the most debated and potentially influential part of the JOBS Act. It will allow anyone, regardless of net worth or income, to invest in private companies through crowdfunding. These donation-based vehicles are already popular for everything from raising money to pay medical bills to helping a friend start their business. Many consumer-facing brands have been successful in pre-sale on these platforms, but contributors often get nothing — at most a token gesture such as a T-shirt or sample product — in return. With Title III, people will actually be able to buy equity through similar platforms.

Still, there are limits. Each company can raise up to $1 million every year, and that could be a major deterrent for any middle-market company that needs to scale quickly. Some big expenses that could easily surpass that $1 million threshold include a national marketing campaign, the financing of inventory, and the acquisition of real estate.

Without the ability to crowdfund at least $5 million to $10 million, I think this section of the JOBS Act in its current form will be restricted to smaller organizations. Also, the method of communication draws the younger-than-35-crowd, and companies seeking to use this method will need to have solid social media networks.

With fewer resources at their disposal, companies that could use the capital will be reluctant to take on additional professional fees for such a small capital raise. Just as Title I lessened the requirements for companies, Title III will add a layer of compliance in the form of reviewed financials. For those raising over $500,000 more than once, audited financials are required.

Higher capital raises under the JOBS Act, such as Regulation A+, require much heavier levels of scrutiny and compliance at state and federal levels — but at least under those programs, the businesses are raising enough so that incurring the required compliance fees is a practical decision.

U.S. Rep. Patrick McHenry, North Carolina Republican, recently proposed increasing the cap on Title III fund-raising from $1 million to $5 million, which could further increase the reach. This would be a step in the right direction, but it is hard to expect these crowdfunding investments will be significant compared to the amount invested by accredited investors.

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