All a Twitter: Why IPOs Are Back

by Dan Brecher on September 24, 2013

Twitter, Inc. recently announced plans for an initial public offering (IPO). The news confirms that companies are increasingly deciding it's a good time to get into the game.

As of August 31, a total of 131 companies have filed to become public in 2013, compared with just 91 during the same time period last year. Other well-known companies that have recently disclosed IPOs include Chrysler Group LLC and Hilton Worldwide Inc.

IPOs are also providing solid returns for investors this year. According to Renaissance Capital LLC, the average return of the IPOs completed in 2013 is 36 percent. Other companies are doing even better. The value of Shutterstock Inc. stock has increased 250 percent since its IPO 11 months ago. Stemline Therapeutics Inc. has seen its shares rise 265 percent.

The resurgence of IPOs suggests that investors have moved on from the flawed Facebook IPO last year. As we have previously discussed on this Business Law Blog, trading glitches and investor lawsuits marred that social media company’s highly anticipated initial public offering. Facebook’s shares fell from a $38 first day price to a low of $17.73 last September, but are now trading significantly higher, at more than $47 a share.

Twitter is likely hoping to generate the same buzz, but with better results. The details of the IPO are still unknown, as the company elected to take advantage of a new provision in the JOBS Act, which allows “emerging growth companies" with less than $1 billion in annual revenue to file their initial documents confidentially. However, many consider Twitter’s decision to rely on this provision as an example of the miscalculation made in enacting a provision that applies equally to a start-up (which needs the benefit of the provision) and to a billion dollar company, such as Twitter (which benefits from the provision, but does not need it).

The lesson here is that to really help create more jobs via IPOs, the number of IPOs would increase dramatically if the SEC would provide smaller issuers, such as those with revenues under $50 million seeking to raise less than $25 million, with needed relief by further easing of the requirements of the more demanding and expensive audit standards, so that small companies don’t have the same audit and reporting requirements as Twitter. Having the same lengthy regulatory review with the same audit rules apply to companies big and small, highly profitable and marginally surviving, seasoned and inexperienced, is not supporting the many business innovators and “job creators” (the smaller companies) who create far more new jobs than do the bigger companies.

While there is the already existing Regulation A exemption for offerings up to $50 million*, it has been used by only a very few companies in recent decades. This is because Regulation A offerings do not yet offer significant enough advantages over full filings with the SEC, because they still entail lengthy SEC review of an Offering Circular, and because the underwriting and after-market trading support that used to be available from numerous smaller broker-dealers have evaporated under heightened FINRA scrutiny of the smaller brokers, most of which have been acquired by larger firms or gone out of business. It is ironic how little use has been made of the Regulation A exemption. Regulators have missed the boat in failing to make $25 million and under public offerings economic and viable.

To further aggressively stimulate the creation of jobs by smaller companies, their engines need to be fed with capital, which the banks are not lending and the larger brokerages are not providing. The SEC needs to rev up the engines with a more realistic and usable Regulation A exemption, lessening the time and expense involved, and FINRA needs a way to assist smaller brokerages in reconstruction of the small offering industry that was a substantial engine of capital formation and job creation in prior decades of financial prosperity here. American IPOs were 90 percent of those completed worldwide fifteen years ago; today we are below 5 percent. While the U. S. regulations and the regulators are only a part of the reason for this decline (our regulations are far more rigorous than those of our overseas competitive exchanges), it will be important and very helpful to our economy if our regulations were made more in line with the present needs of small companies to obtain public capital, instead of the end-around practice of seeking hedge fund financing followed by reverse merger capitalizations, many of which have been fraught with problems.

If you have any questions about this post or would like to discuss the legal issues involved, please contact me, Dan Brecher, or the Scarinci Hollenbeck attorney with whom you work.

*I co-authored “When Making a Small Offering Under Regulation A,” 26 The Practical Lawyer, Nos. 2 and 3; republished in the American Law Institute-American Bar Association’s The Practical Lawyers Manual of Business Forms and Checklists.