



# Hearing on legislative proposals to promote job creation, capital formation and market certainty

Statement of David Weild, Senior Advisor — Grant Thornton LLP  
before the U.S. House of Representatives Financial Services Committee  
Capital Markets and Government Sponsored Enterprises Subcommittee  
March 16, 2011



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## Introduction

Chairman Garrett, Ranking Member Waters and members of the Subcommittee, thank you for inviting me to testify this afternoon on Job Creation, Capital Formation and Market Certainty — issues critical to our nation's economic future.

My name is David Weild, and I am the Senior Advisor overseeing the Capital Markets Group of Grant Thornton LLP, one of the six global audit, tax and advisory organizations.

Grant Thornton Capital Markets Group provides analysis, insight and support to companies accessing today's global capital markets. These companies run the gamut from private companies that are bootstrapped by mom and pop entrepreneurs to venture capital and private equity-backed companies — both small and large.

## Summary

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The United States stock market, once the envy of the world, has suffered a devastating decline in numbers of small initial public offerings (IPOs). Our research and analysis of relevant data strongly demonstrates that small businesses and entrepreneurs cannot access the capital they need to grow and create jobs. The United States is losing more public companies from our listed stock exchanges than we are replacing with new IPOs. When measured by number of listed companies, America's stock exchanges are declining, while those of other developed nations are increasing. It is imperative that Congress, regulators and stakeholders in the debate evaluate and take action to increase the number of U.S. publicly listed companies.

As outlined in the Small Company Capital Formation Act of 2011 (the Reg A bill), an increase to the Regulation A (or Reg A) ceiling will provide a less costly and more effective alternative for smaller, entrepreneurial companies that want to access the public capital markets. It may also enable smaller, growth-oriented companies to access the public market at an earlier stage in their growth cycle.

Passage of the proposed Reg A bill is a necessary first step in a campaign to bring back the small IPO, generate jobs and revitalize the U.S. economy.

## Small initial public offerings — the catalyst for creating new jobs — have nearly disappeared

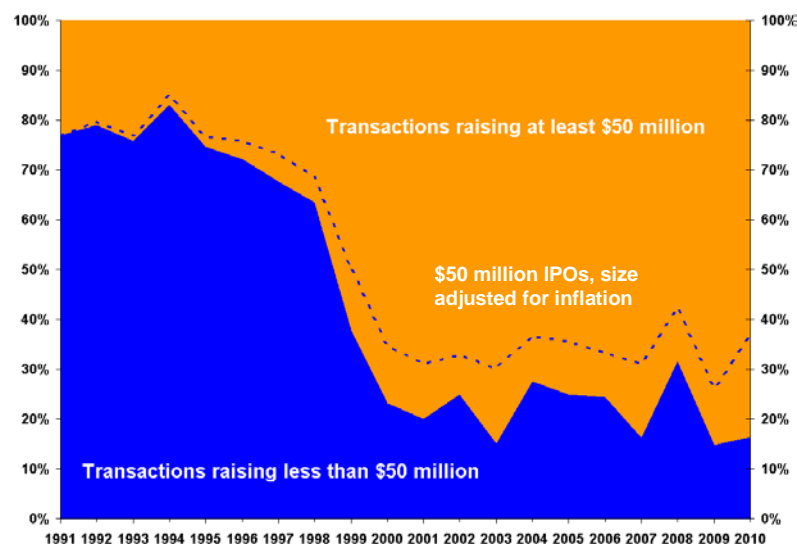
As you can see in Figure 1, from 1991 to 1997, nearly 80% of U.S. IPOs were smaller than \$50 million. By 2000, the number of sub-\$50 million IPOs had declined to only 20% of the market. When small businesses cannot access capital to fuel their expansion, high-quality job creation is harmed.

Interestingly, the bigger-IPO decades of the 1980s and 1990s produced more than 20 million net new jobs per decade, while the 2000s decade produced none: According to *The Washington Post*, “There ... [was] zero net job creation since December 1999. No previous decade going back to the 1940s had job growth of less than 20 percent.”<sup>1</sup>

Perhaps most alarming is that small IPOs — defined as those raising less than \$50 million — have practically gone the way of the dodo bird, becoming virtually extinct.

Figure 1

### Small IPOs have gone the way of the dodo bird.



Sources: Dealogic, Capital Markets Advisory Partners  
Data includes corporate IPOs as of 12/31/10, excluding funds, REITs, SPACS and LPs.

<sup>1</sup> “Aughts were a lost decade for U.S. Economy, Workers” by Neil Irwin, *The Washington Post*, Jan 2, 2010.

### The United States is losing more public companies than we are replacing with new IPOs, causing job depletion rather than job creation

The United States' capacity to generate new listings is well below replacement needs. In an average year, it takes approximately 360 new listings just to replace delistings from U.S. stock markets, and upwards of 520 new listings per year to grow the number of listed companies at 3% GDP rates. We've not seen numbers like this in over a decade.

We are losing far more companies than we are replacing with new IPOs. We have averaged only 129 IPOs per year since 2001, with only 61 IPOs in 2009 and 153 IPOs in 2010 — this compared to the headiness of 1991-2000 with averages of 530 IPOs per year.

### Technological, regulatory and legislative change destroyed the U.S. IPO market

Figure 1 shows us that the decline in small IPOs began in the mid-1990s, long before Sarbanes-Oxley took effect in 2002. The root cause — not addressed by the Reg A bill — is the loss of the stock market model that provided the broker-dealer community with the economics necessary to sustain infrastructure investments that are essential to support small companies once they are public. Essentially, regulatory changes pulled the rug out from under small public companies.

Research analysts, salesmen and liquidity providers are the infrastructure — the bridges, roads and tunnels — of a stock market that supports small public companies. Strip away the revenue model that pays for this infrastructure, and the IPO market goes into secular decline — just as commerce suffers without continued investment in bridges, roads and tunnels.

Today's one-size-fits-all stock market model — the unintended consequence of well-intended regulatory change — has deprived issuers in this country of any real alternative as to how their stocks are supported. And while certain stocks will support demand themselves through their larger-than-life brands — Facebook, Twitter and anything that is “Brand China” — the vast majority of IPOs, once they are public, will need significant support manufactured for their stocks. In today's stock market, that support has been lost and is now a major hidden and undocumented cost to public companies. The problem can be traced back to a series of regulatory changes that were uncoordinated, near-sighted and ultimately destructive to the small capitalization IPO market, which has been the growth engine of our stock markets and our economy for a century.<sup>2</sup> This is more significant than people generally understand, because the median exchange-listed company is a “microcap” stock — with only a \$450 million equity market value.

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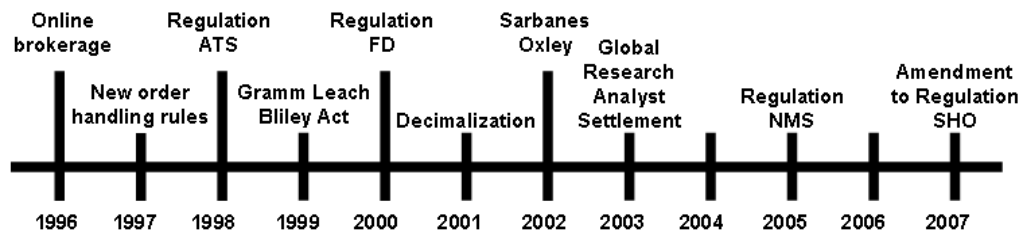
<sup>2</sup> In December 2009, our studies were entered into the public record by Senator Ted Kaufman (D-DE) during a speech: “Kaufman calls decline in IPOs ‘choke point’ to job creation, economic recovery.”

How did we get to this point?

Beginning in 1997, cumulative actions by Congress and the SEC — all nobly aimed at lowering transaction costs for individuals — had the disastrous consequence of destroying the economic infrastructure that made it possible for small cap IPOs to thrive on our markets (Figure 2). We call this “The Stock Market Consumer Paradox”: Consumers are harmed by transaction costs that are too low to pay for the equity research, sales and liquidity (capital) necessary to support small cap public companies. Jobs are lost. Investment returns decline. Innovation declines. National security — dependent on innovation — is compromised. Consumers are harmed.

Figure 2

**A series of unfortunate events**



Source: “The Perfect Storm,” pp. 21-23, *Market structure is causing the IPO crisis — and more*, by David Weild and Edward Kim, June 2010, published by Grant Thornton.

Since 2008, Edward Kim and I have co-authored several Grant Thornton studies<sup>3</sup> that are recognized by many in the industry as the authoritative works that first documented and detailed the reasons behind this decline in the U.S. stock markets. The conclusions are alarming. Every year since 1997, we have suffered a decline in the number of listed companies on our stock exchanges. Every. Single. Year.

Trading spreads and commissions collapsed to pennies and sub-pennies; long-term investment was quickly replaced by short-term trading; and investment banks cut capital, sales and research support to small cap stocks in an effort to make diminished revenues cover costs. Many investment banks sold out to larger firms, went out of business or pursued other more lucrative and less socially advantageous lines of business.

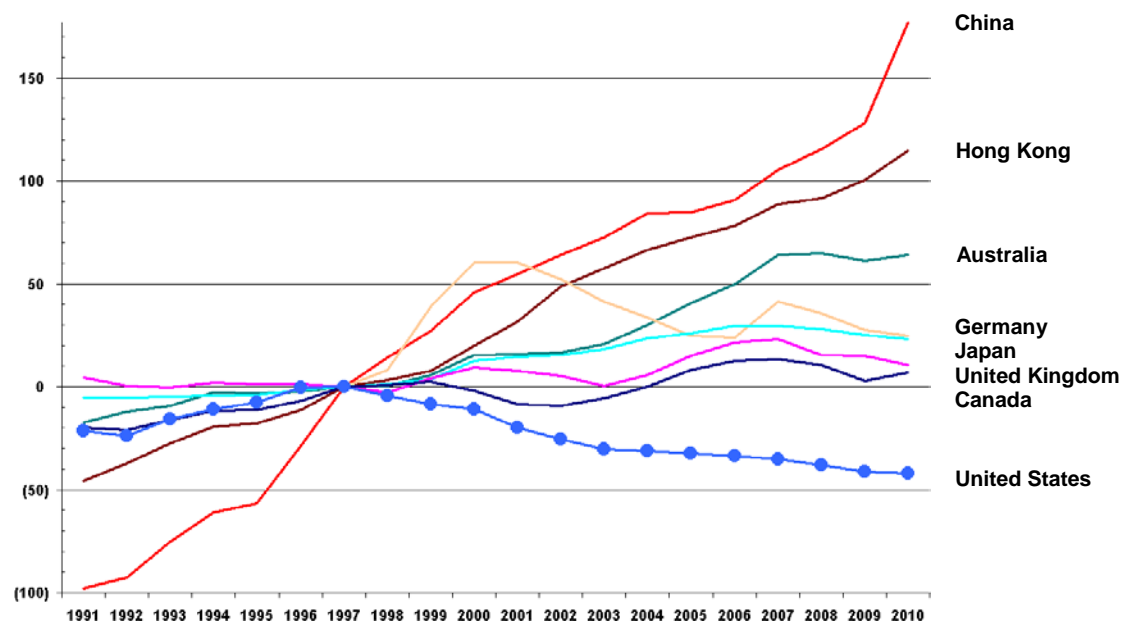
<sup>3</sup> Weild, David and Kim, Edward, “Why are IPOs in the ICU?,” November 2008; Weild and Kim, “Market structure is causing the IPO crisis,” October 2009; Weild and Kim, “A wake-up call for America,” November 2009; Weild and Kim, “Market structure is causing the IPO crisis — and more,” June 2010.

## The United States’ market listings are declining, while those of other nations are increasing

The U.S. has experienced a decline in market listings, while other developed nations have enjoyed significant increases. In 1997, there were a total 8,823 publicly listed companies on the New York Stock Exchange, NASDAQ Stock Market and American Stock Exchange. That number represents the peak of listings in this country. In a span of just 13 years, that number has dropped by over 42% to a mere 5,091 listings as of the end of February 2011.<sup>4</sup> No other developed nation has experienced such a decline. In fact, most have enjoyed increases, with the Asian markets — notably in China and Hong Kong — showing particular strength (Figure 3). If that doesn’t scare us, then nothing will. This is our self-induced economic immolation, and we — as Americans — can and must do better than this.

Figure 3

**U.S. listings have decreased by over 42% since 1997. Listings are indexed to 1997.**



Sources: World Federation of Exchanges, Capital Markets Advisory Partners, Grant Thornton LLP.

<sup>4</sup> World Federation of Exchanges.



The crux of this U.S. decline is the loss of support for small IPOs, defined as those raising less than \$50 million. Intel, Amgen, Oracle, Cisco, Starbucks, Yahoo! — each of these companies raised less than \$50 million when they went public.

The number of IPOs needed to maintain our markets and to drive GDP growth is *much* larger than anything seen in the IPO market over the last decade, and we applaud the Small Company Capital Formation Act of 2011 (the Reg A bill) as the beginning of a campaign to bring back the small IPO, the U.S. economy and our stock markets.

# Regulation A

## Background

Regulation A was originally enacted during the Great Depression to help the economy by improving small business access to equity capital. Few start-ups and growth companies have the option to borrow money from a bank, and consequently, access to equity “risk capital” is essential to drive entrepreneurship — not just for venture-backed companies, but for “mom and pop” entrepreneurs as well. So when the IPO market catches a cold, private businesses’ access to risk capital may catch pneumonia.

## Impact of the Reg A bill on capital formation and job creation

This bill does three things that are enormously beneficial for small companies, capital formation and, in turn, the U.S. economy:

1. It will drive down costs for issuers by permitting the use of a simpler “Offering Circular” for the SEC’s review.
2. It opens up the Regulation A exemption to a size that will allow companies to list on the NYSE and NASDAQ and to avail themselves of the so-called “Blue Sky” exemption, thus avoiding very costly state-by-state filings (the current Reg A limit of \$5 million is below NYSE and NASDAQ listing minimums).
3. It will allow issuers to gauge the viability of an offering by meeting with investors *before* incurring the significant costs of an offering.

This last, so-called “testing-the-waters” provision may not seem like much, but there has been a steady increase<sup>5</sup> — dating back to the mid-1990s — in IPOs that are postponed, withdrawn, priced below the low end of the IPO filing range or that have broken the IPO price within 30 days of the completion of the offering. These so-called “busted deals” can be ruinous to small companies: As recently as 2009, “busted deals” exceeded 70% of all IPOs.

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<sup>5</sup> *Transaction Leverage* by David Weild and Edward Kim, 2011.

### Recommend passage of the Reg A bill with stipulations

I fully endorse the passage of this bill to increase the cap on Regulation A from \$5 million to \$50 million, with the following requirements:

1. That issuers file audited financial statements with the Securities and Exchange Commission and distribute such statements to prospective investors
2. That issuers be required to submit their offering statements to the SEC electronically
3. That periodic disclosures be determined by the SEC (we recommend that they mimic those required of registered companies)
4. That the SEC stipulate so-called “bad boy” provisions to disqualify from participation in this market those individuals or entities with a disciplinary or criminal history.

In addition, I would make one minor suggestion to the Reg A bill: that all financings are done through a FINRA-registered firm. My concern is that a minority of unscrupulous investors will pitch adverse deal structures (e.g., “death spiral converts”) and that issuers may not understand these structures’ implications to the company or its shareholders. While this may be controlled for at the listed-company level (i.e., NYSE and NASDAQ) through the rulemaking of our stock exchanges, it would not be controlled for in the “over-the-counter market.” Requiring the use of a FINRA-registered firm might minimize abuse.

## Conclusion

I applaud the Subcommittee for seeking solutions to the capital formation challenges that small growth companies face and for recognizing that action must be taken to drive job creation and economic growth. For the reasons enumerated, I firmly support the passage of the Small Company Capital Formation Act of 2011.

Please note, however, that this Reg A bill alone is not nearly sufficient to get the IPO market back on track and to get America back on the path to prosperity. Therefore I am also calling for the chartering by Congress of a new national stock market — one that focuses on providing the essential economic model that sustains the infrastructure needed to support small public companies and drives long-term growth and prosperity for all Americans. A market such as this would also drive tax revenues without costing taxpayers a dime.

Thank you for this opportunity to present information on such an important topic. I am pleased to answer any questions.

## About David Weild

David Weild is a Senior Advisor to Grant Thornton LLP's Capital Markets Group, which provides strategies and insights into today's global capital markets.

### Experience

David is the founder of Capital Markets Advisory Partners and the former vice-chairman and executive vice-president of The NASDAQ Stock Market, with oversight of the more than 4,000 listed companies. Prior to NASDAQ, he spent 14 years at Prudential Securities in a number of senior management roles, including president of eCommerce, head of corporate finance, head of technology investment banking and head of equity capital markets in New York, London and Tokyo. He worked on more than 1,000 IPOs, follow-on offerings and convertible transactions and was an innovator of new issue systems and securities underwriting structures, including the use of Form S-3s to mitigate risk for small capitalization companies raising equity and convertible debt capital. He created the Market Intelligence Desk — or “MID” — while at NASDAQ to support issuers in their quest to better understand what was impacting trading in their stocks.

### Education

David holds an MBA from the Stern School of Business and a BA from Wesleyan University. He has studied on exchange at The Sorbonne, Ecole des Haute Etudes Commerciales and The Stockholm School of Economics.

### Industry participation

David has participated in the NYSE's and National Venture Capital Association's Blue Ribbon Regional Task Force to explore ways to help restore a vibrant IPO market and keep innovation flourishing in the United States, and in the International Stock Exchange Executives Emeriti Small Business Financing Crisis Task Force. He served as Director of the National Investor Relations Institute's New York chapter and currently holds board positions at Helium.com and Hanley & Associates. David testified recently before the CFTC-SEC Joint Panel on Emerging Regulatory Issues in the wake of the May 2010 “flash crash” and is often interviewed by the financial news media.

### Publications

David and Edward Kim have co-authored a number of Grant Thornton studies, including *Why are IPOs in the ICU?* in 2008. Released in the fall of 2009, *Market structure is causing the IPO crisis* (updated by [Market structure is causing the IPO crisis — and more](#) in 2010) and [A wake-up call for America](#) have been entered into the Congressional Record and the Federal Register.

## About Grant Thornton LLP

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