The Brilliance of Regulation A+

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On February 20th, 2016, the first Regulation A+ company went public. Elios Motors closed a $17 million financing from over 6,000 investors with an average investment of $2,800. This is the beginning of a sea change in the capital markets for early-stage companies. The impact on the stagnant US economy could be dramatic.

The purpose of Reg A+ (Title IV of the JOBS Act), was to make it easier for small companies to raise capital from the public by reducing the regulatory and reporting burdens and their associated costs. It appears to have accomplished this purpose. Companies that use Reg A+ can now do the following:

- Generally solicit and advertise to non-accredited investors
- Offer a unrestricted and tradable security
- Raise up to $50 million per year
- Subject to light reporting requirements
- Avoid state Blue Sky securities regulation
- Include an unlimited number of investors to participate in an offering

Elio Motors was the first company to use Reg A+ to crowdfund and become a public entity. Best described as a high-risk venture capital investment, the Elio offering is interesting for several reasons, one of which is that it was the only company to go public in January after the IPO window had slammed shut. Nevertheless, the company raised $17 million at a $240 million valuation without the help of Wall Street.

Is this a pent up demand for non-accredited investors to become venture capitalists? An example of savvy marketing? A brilliant product? Or a combination of all of the above?

The Elios experience reflects how Regulation A+ has the potential to change how capital is raised and the financing strategies for growth companies. The key drivers include:

Public Venture Capital. Average investors can now access alternative investments, like venture capital, previously available to only the wealthy. This could mean a big infusion of risk capital into the market, as 120 million non-accredited US households can now directly invest in venture deals.

Customers as Shareholders and Brand Ambassadors. Upstart companies can now directly solicit their customers to become their shareholders. By tapping into "Affinity Groups", personally connected to a company's product or service, companies can build a following of those passionate about what they sell and create *brand ambassadors* who will buy and hold stock and encourage others to do the same.

Management Efficiency. A growth company's most precious asset is the CEOs time. Entrepreneurs today are consumed by capital raising which is simply the greatest misapplication of talent in the US economy. Chasing investors *doesn't* build a business. Chasing customers *does* build a business. If customers as prospective shareholders and CEOs can raise capital *while* building customers relationships, companies become stronger faster.

Liquidity. The lack of liquidity makes investments in private companies unattractive. It is like a roach motel: you can get in, but can't get out. The "liquidity premium" (the value of a tradable security over a non-tradable security) can exceed 100%. The freely-tradable nature of a Reg A+ security gives companies an immediate increase in value over the alternative of being a Reg D offering (the exemption used by every law abiding private company today). Of course, this premium depends on the existence of a secondary market, but having freely-tradable shares is step one. Secondary markets will appear and a new class of securities will emerge: tradable private equities, or "tradable privates". Hopefully they will have a better outcome than other notable financial innovations, such as high yield debt (a/k/a Junk Bonds), Mortgage Backed Securities and Collateralized Debt Obligations.

Valuation. All the above factors combined will drive valuations of these emerging companies higher. This is good for entrepreneurs, but not so good for venture investors, who currently lack competition for these deals, and who, in actuality, haven't been investing in early-stage companies for a long time. Reg A+ in fact will be a valuable exit to monetize portfolio companies and to recycle those funds into new investments.

Angel Investors. The same holds true for angel investors, who can harvest their investments and recycle their money into new companies. This is a huge upside to the overall economy and a chance to bring back the virtuous circle of the past, before technology, short-sighted policy and regulation drove out the economics and destroyed a financial ecosystem that was once the envy of the world.

New Financial Strategies. Reg A+ also provides an efficient "on ramp" to becoming public. It provides a more orderly process. Similar to the way young ballplayers develop in the minor leagues before the majors, young companies can now avoid the shock to their system of going public too early. Reg A+ companies can remain private while putting investor relations and reporting infrastructure in place. They can focus on building their business instead of worrying about earnings releases, trading volume, quarter-to-quarter results and short sellers. When they are solid and ready to go public, they can "uplist" more economically and with far less stress.

New Market Structure: Wall Street + Madison Avenue The JOBS Act has created an entirely new class of service providers to meet the needs of this emergent market. The investment banks of the future will look more like advertising and marketing agencies, using video, public relations, and social media to market securities through portals and technology platforms. No one has yet run ads during the Super Bowl to buy stock in a company, but that day will come. The Internet is changing the finance sector. it is how Elios attracted 6,000 investors to invest an average of $2,800 average.

It is still hard to raise money. Despite its many virtues, Reg A+ is just a structure. It is not a ticket to a financing. A company still must sell its offering. There are Reg A+ listings at this moment that are languishing or won't be completed because of insufficient marketing. Why? This is a new industry, and there is little infrastructure in place. There are rich oil deposits below but few drilling rigs and oilmen who know how to get to it. At the time of this writing, there is only one investment bank serving this market.

There are no big fees from small offerings and there are no fees from trading in these stocks. Wall Street is driven by fees, so it is no wonder they aren't rushing to get involved. But that will change. It is the nature of disruption of markets. The low cost providers come in and offer most of what higher cost providers do a lower price. They then move upmarket and gradually take business from those higher in the food chain. These new providers will secure clients early and keep them. And then the big banks will have to acquire the upstarts. It's always been that way. There is nothing new under the sun.

In conclusion. Reg A+ vs. D. In 2014, there were 31,000 Reg D filings in the United States, versus a mere 18 Reg A+ filings. Over time, these numbers will converge. The familiarity of the Reg D is more than offset by the benefits of Reg A+. Any company serious about growth and providing returns will need to put in place the systems and transparency that deliver liquidity to investors. The sooner they start, the lower the cost and the stronger the business.

Ultimately, the success of Regulation A+ will be driven by liquidity, which will depend upon aftermarket support. This, in turn, hinges on the professionals in this nascent sector delivering innovations, efficiency and quality. It will also mean collaborating with the regulators to stop bad actors from ruining what is the most important economic legislation passed in a generation. Jobs are created by small business and entrepreneurs. If they have capital, there will be jobs. It is no more complicated than that. And jobs are desperately needed in a country whose economic policies have failed its working and middle class. It is why we are witnessing a political system coming unglued as the public revolts against our current rigged system of **crony capitalism.**

Reg A+ offers some hope of saving the country and bring back **free market capitalism**. Policy matters. The JOBS Act and Regulation A+ is good economic policy. Hopefully it will kick into broad use and acceptance and help finance the job-generating companies upon which this country's future depends.