



Remarks of
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Commissioner
United States Securities Commission

Before the
National Small Business United
and the
National Association of Women Business Owners

Washington, D.C.
May 12, 1992

***The views expressed herein are those of Commissioner Beese and do not necessarily represent those of the Commission, other Commissioners or the staff.**

**U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549**

THE SEC'S SMALL BUSINESS INITIATIVE

I. Introduction

Good morning. I feel privileged to be here today during Small Business Week and to address a group of some of the leading small business owners in the United States. National Small Business Week was established to recognize the significant contributions of small businesses and their owners. I can think of no better way to commemorate it than to be with you today.

As some of you may know, before I became the newest Commissioner of the SEC, I spent 14 years at the investment banking firm of Alex Brown & Sons. During that time, the firm brought public hundreds of companies, particularly in the computer software, health care, environmental technology, and retailing industries.

I am also proud to say that in 1990 I was asked to serve as a member of the Committee on Financing Technology in U.S., a joint effort of the Treasury and Commerce Departments. The Committee was established to study why current levels of technology investment in the United States appear to be inadequate to meet global

competition. Participation on the Committee included CEOs, CFOs, senior government officials, investment bankers, and large investors, ensuring a broad cross-section of market participants and regulators. Over the past two years, the Committee spent a good deal of time assessing the ability of small technology companies to raise money.

These experiences gave me an appreciation for the unique needs and problems of small and start-up businesses. Today, I would like to talk about a specific problem facing many companies, large and small: raising capital.

II. Small Business Initiative

Recently, the Commission announced the Small Business Initiative, which is a set of proposals to facilitate capital raising among small businesses. I believe that these proposals could significantly reduce the regulatory costs faced by small businesses seeking funding.

Small businesses are the backbone of America. Not only do they supply a large number of jobs to the economy, but they are often the source of innovative thinking and entrepreneurial spirit.

There are approximately 20 million small companies in the United States who collectively account for at least half of the U.S. gross domestic product and who collectively employ more than half our labor force. Between 1988 and 1990 small companies created, in the aggregate, more than 100% of all new jobs in the economy. And women-owned businesses recently have provided more jobs to the economy than did the Fortune 500.^{1/}

Perhaps even more noteworthy is the fact that small businesses are often the breeding ground for some this country's most innovative ideas. Many of the technological breakthroughs we all take for granted are a direct result of the innovative thinking of small business entrepreneurs.

1/ National Foundation for Women Business Owners Press Release, March 31, 1992.

Unfortunately, small companies frequently experience real difficulty in raising capital, despite their crucial role in our economy.

The Technology Committee discussions were very enlightening on this issue. Interestingly, the Committee defined companies as "small" based on their ability to raise capital: The Committee believed that a small company is one that has to convince outsiders of the soundness of its business plan, market opportunity, and management capability to raise funding. In contrast, it defined a "large company" as one that raises funds on the basis of its overall strength. This very definition highlights one of the biggest hurdles that small companies face.

Very often, small companies fund their start-up phase through personal savings, credit card lines of credit, and backing from family members and friends. A second important source of funding is so-called "business angels," high net worth individuals who are frequently entrepreneurs themselves and who invest in small

companies. Although there are no hard numbers on business angel activity, the conclusion of the Technology Committee is that there is no effective mechanism for bringing companies seeking funding together with business angels.

Business development companies, which are investment companies created to invest in small and start-up companies, provide another alternative source of funding. Unfortunately, this potential source has hardly been tapped because of technical barriers in the securities laws.

Other important sources of capital for companies in what we call "the pre-IPO phase" have traditionally been bank loans and venture capital funds. In the last few years, however, we have seen the funds available from these sources dry up, or at least drop dramatically. Currently, these traditional sources are not meeting the needs of smaller companies. The Federal Reserve Board reported that outstanding bank commercial and industrial loans have declined about \$30 billion in the past year alone. They have fallen even more steeply

compared with overall bank asset growth. In addition, venture capital fund investment in small businesses has seriously declined to less than \$2 billion in 1991, compared with over \$4 billion in 1987.

What are the reasons for this? I believe that there are two main contributing factors: one cyclical and one more structural in nature. First, the past recession had a disproportionate impact on small business financing. Second, I believe that our regulatory systems do not yet fully address the special needs of small businesses in accessing the capital markets. In many respects, when regulatory structures were created, it was with established businesses in mind, and not the special needs of entrepreneurs.

We have to take a hard look at the effect of government regulation on small business. Small and large businesses alike are subject to a broad panoply of regulations -- at both the state and federal level. Some of this is undoubtedly not only unnecessary, but is exacting a cost that is intolerable.

It is for that reason that I applaud the President's recent request that the various departments and agencies review their programs to eliminate unnecessary burdens. I believe that government should continuously engage in this kind of review.

In addition, I am pleased to be able to describe for you the SEC's efforts on our Small Business Initiative. The proposals include numerous changes to existing SEC rules and legislative proposals to amend the Securities Act of 1933 and the Investment Company Act of 1940. They are intended to achieve several goals:

- **First, they should simplify disclosure requirements for small businesses, while retaining essential information for investors.**

- **Second, the proposals are designed to make it easier for a small business to tap the capital markets for funds earlier in the company's life cycle.**

- Third, the proposals should make it easier and less costly to form pooled investment vehicles, like venture capital funds and business development companies.

Now let me turn to the specifics of the proposals.

A. Facilitating Seed Capital Offerings

Rule 504 under the Securities Act provides an exemption for companies to raise up to \$1 million per year, if they meet certain conditions. Small companies often make use of this exemption to raise money more cost effectively. The SEC has now proposed amendments to Rule 504 to make it an even more appealing vehicle for start-up companies.

The proposal would allow companies to raise up to \$1 million per year through sales of securities that could be freely traded without registration under the Securities Act and without complying with the current requirement that the securities be registered with the states. For the first time, companies would be permitted to generally

advertise and solicit interest in connection with all offers and sales under the exemption.

B. Regulation A Offerings

Companies that are seeking a wider, more liquid market for their securities often take advantage of the simplified form of registration provided by Regulation A. Under this alternative, companies do not have to provide certified financial statements, and they can provide less detailed disclosure about the company. Finally, no continuous reporting obligation automatically results from the offering.

The SEC recently proposed revisions to Regulation A that should make it even more attractive to small issuers. Specifically these proposed revisions would:

- raise the annual dollar limit on offerings from \$1.5 million to \$5 million;

- permit the use of a simple question and answer format for the offering circular; and
- permit companies to, as we say, "test the waters," to see if investor interest exists before incurring the expense of preparing offering documents.

These changes should make it much less costly for small businesses to raise greater amounts of capital.

As Chart A shows, the average length of registration documents submitted to the SEC in compliance with Regulation A is 41 pages, compared with 76 pages for the average Form S-1, which is the form for full registration. That translates into significant cost savings. If we turn to Chart B, we can see that on average, the cost of a Regulation A offering is \$31,000; compared with \$622,000 for the average S-1 registration.

C. Registration and Reporting Requirements for Small Businesses

Some small businesses choose to raise money through registered public offerings, perhaps because of the dollar limitations on exempt offerings and perhaps to create a more visible presence. As we just saw, however, a small company's costs of complying with the registration and reporting requirements can be disproportionately large.

Some time ago, the SEC adopted a simplified registration form - - Form S-18 -- in recognition of this problem. Building on that model, the SEC is now proposing a new series of forms for registration and periodic reporting purposes to be used by companies with revenues of less than \$15 million. The proposed forms are Form SB-1 for registration and 10K and 10Q "junior" for periodic reporting. The disclosure requirements in these new forms have been rewritten to be more easily understood by someone less familiar with the federal securities laws and regulations.

If we turn again to Chart B we can see that the anticipated savings from Form SB-1 should be substantial. Comparing the average cost of preparing a Form S-1 with the projected average cost of using proposed Form SB-1, shows potential savings of \$414,000 per offering.

As you can see from Chart C, a substantial number of public companies would be eligible to use the new, simplified periodic reporting forms. Of the estimated 12,000 public companies, approximately 4,160 companies, which have less than \$15 million in annual revenues, or 35% of all reporting companies, could use the proposed forms.

D. Streamlining Procedures for Small Debt Offerings

The SEC has also taken steps to eliminate some of the requirements on smaller debt offerings under the Trust Indenture Act. Currently, small issuers may offer up to \$2 million without an indenture, the document that governs the rights of security holders and the obligations of issuers. The Commission has proposed

increasing to \$5 million the amount of securities that can be issued without an indenture. In addition, the Commission proposed exempting from compliance with the Trust Indenture Act any offering of debt securities that is exempt from registration under Regulation A. The rationale for this is that application of the Trust Indenture Act would unnecessarily complicate offerings under Regulation A and defeat somewhat the purposes of that offering alternative.

E. Investment Companies

Finally, let me briefly mention several proposals under consideration to amend the Investment Company Act. The proposals are targeted at the four specialized types of investment companies that invest in small or start-up businesses: private investment companies, business development companies, business and industrial development companies and small business investment companies. The proposals would modify a variety of restrictions that apply to such companies to make it easier for them to invest in small businesses. The proposals should make these types of investment companies far more attractive as small business investment vehicles.

III. Conclusion

All of the proposals that I have just described are intended to ease entry to the capital markets for small companies, without sacrificing investor protection.

This is an important point.

There will inevitably be some who will criticize the SEC for loosening up disclosure requirements -- even though these proposals are designed to assure that investors have necessary information to make informed investment decisions. But it is also important to note that nothing in the proposals I have described provides an issuer with a safe harbor to commit fraud. The SEC's first responsibility is to protect investors and to that end I want to assure you that the SEC has a strong commitment to rooting out and punishing fraud. Our capital markets are widely recognized as the fairest and most efficient in the world, due to both appropriate disclosure requirements and effective enforcement. Over \$40 trillion in securities transactions take place in the United States annually. By any measure, fraud in our

markets is substantially less than 1% of annual volume, making U.S. securities markets the model for the world. It is in all of our best interests to make sure that our markets remain the fairest, safest and most liquid markets in the world.

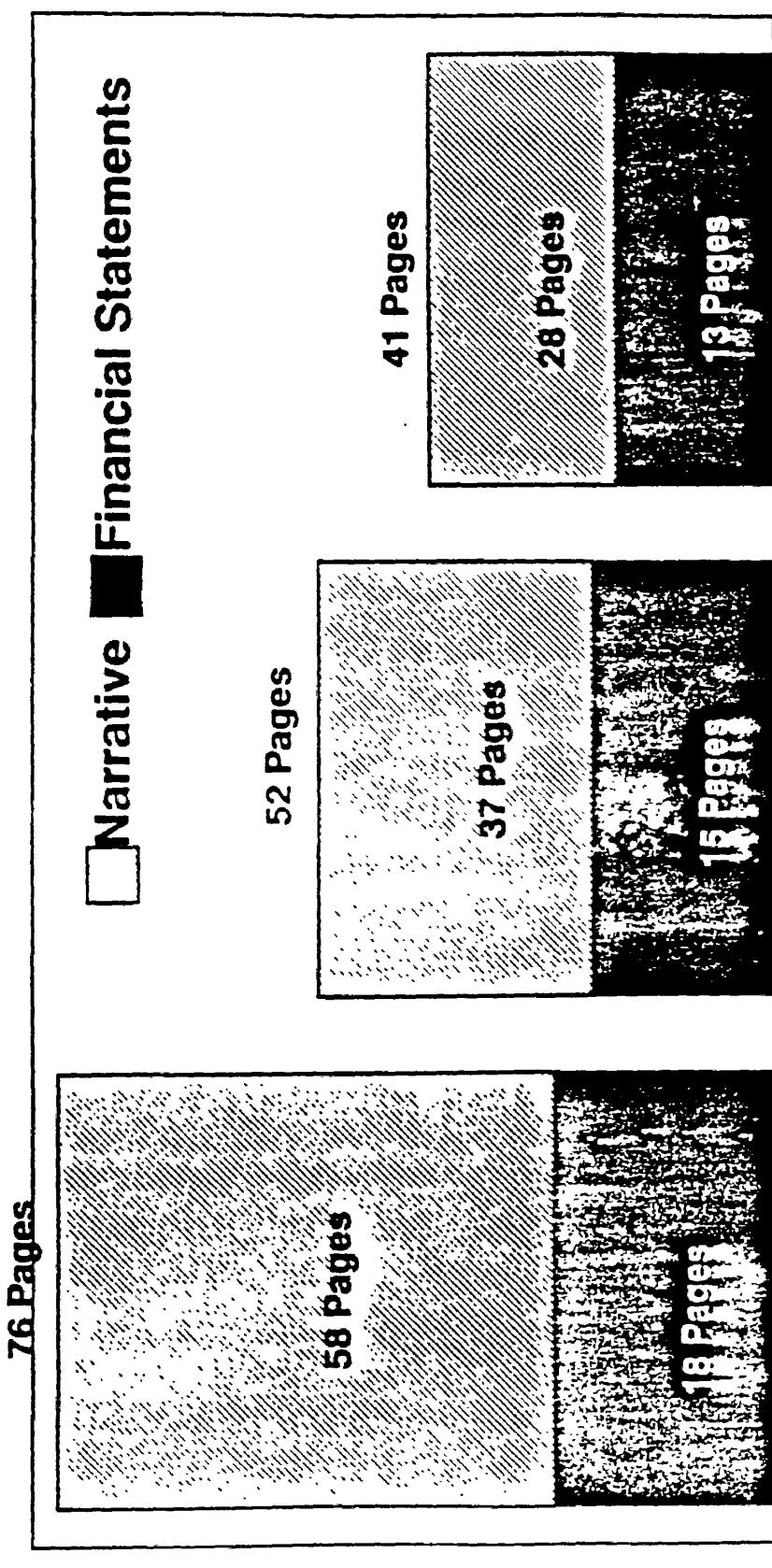
In closing, I would like to say once again that the Commission recognizes the crucial role small businesses play in this country's economy. I assure you that we will continue to be sensitive to the unique needs of small businesses. I urge you to continue to bring those needs to our attention, particularly through such fine organizations as the NSBU and NAWBO.

Thank you.

Benefits of Using Form S-18 and Reg A Components Of Disclosure Documents

Financial and Narrative Sections (1991)

CHART A



S-18

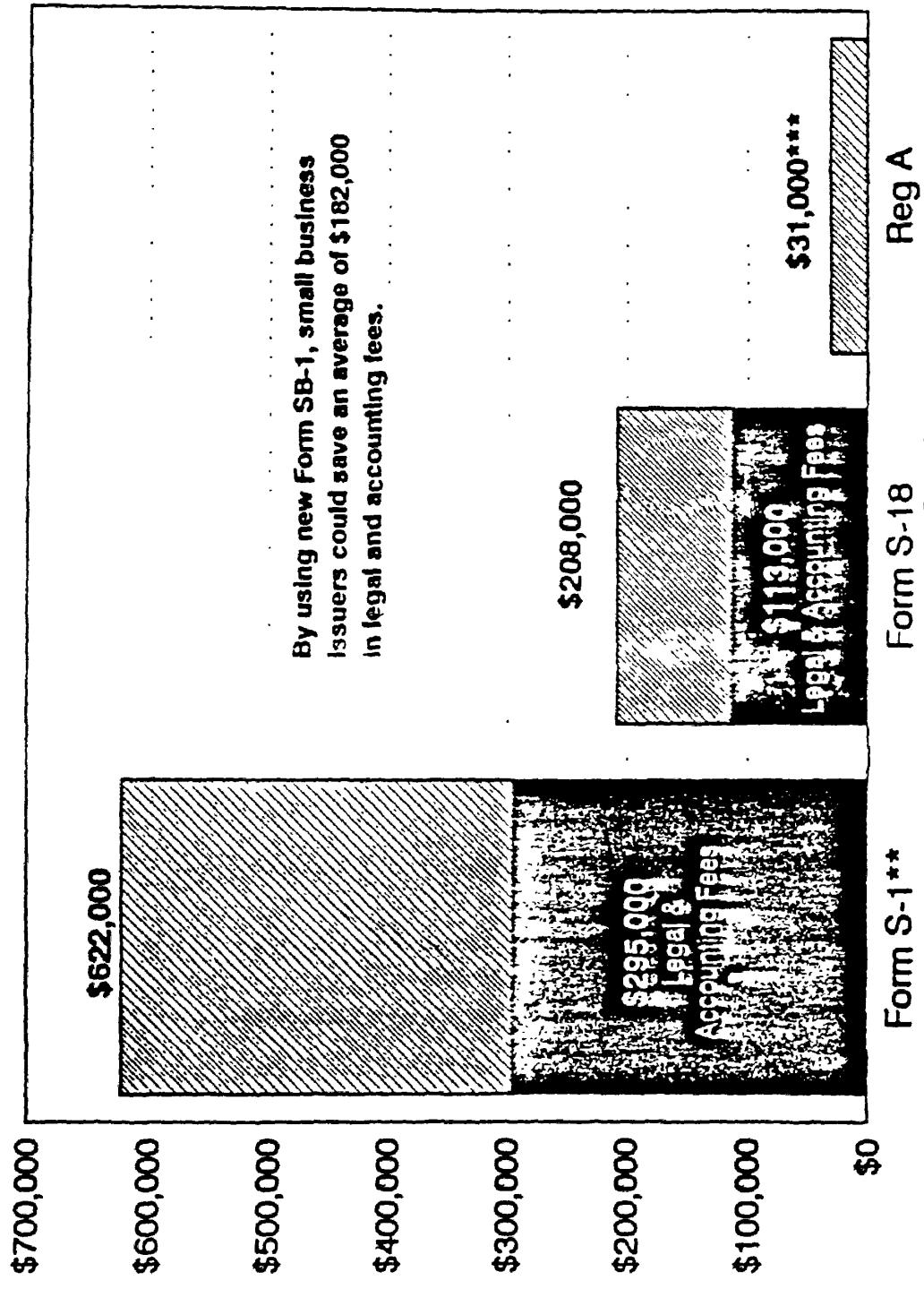
REG A

(Small Business Common Stock IPO)

Note: Average length of filings Jan. - Dec. 1991
Source: Securities and Exchange Commission

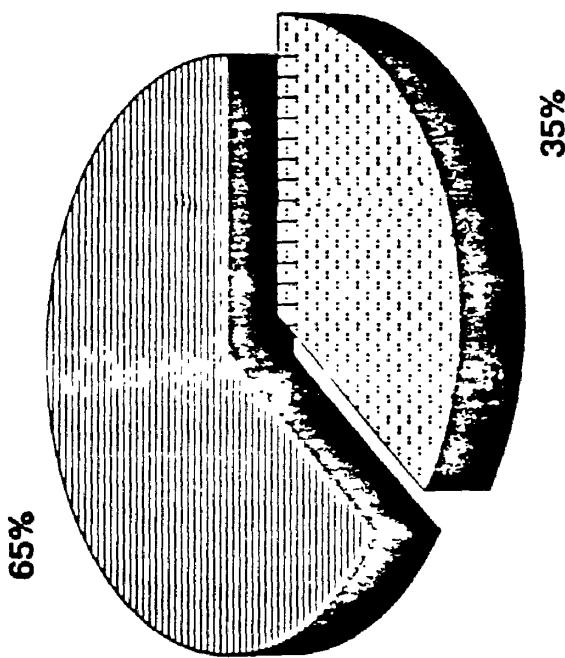
Average Expenses of Initial Public Offerings*

1991



Public Companies Eligible for Simplified Disclosure (Small Business Issuers)

Estimated 12,000 currently reporting companies*



An estimated 4,160 reporting companies with less than \$15M in annual revenues would be able to use simplified annual and quarterly reports ("junior" 10-Ks and 10-Qs) and Form SB-1

*Note: Reporting companies under Sections 12 & 15(d) of the Exchange Act

Source: Securities and Exchange Commission