

Capital Formation Outlook 2024

The SEC has three primary tasks: protect investors, maintain fair and orderly markets, and facilitate capital formation. While the SEC issued a record number of proposals and final rules in 2023, the focus has concentrated mostly on investor protection and market structure. The SEC’s Office of the Advocate for Small Business Capital Formation (OAS) recently issued its [2023 report](#) that highlights recent market trends and the group’s policy recommendations for Congress and the SEC to consider in 2024 to improve access to capital, especially for startups and smaller and midsize companies.

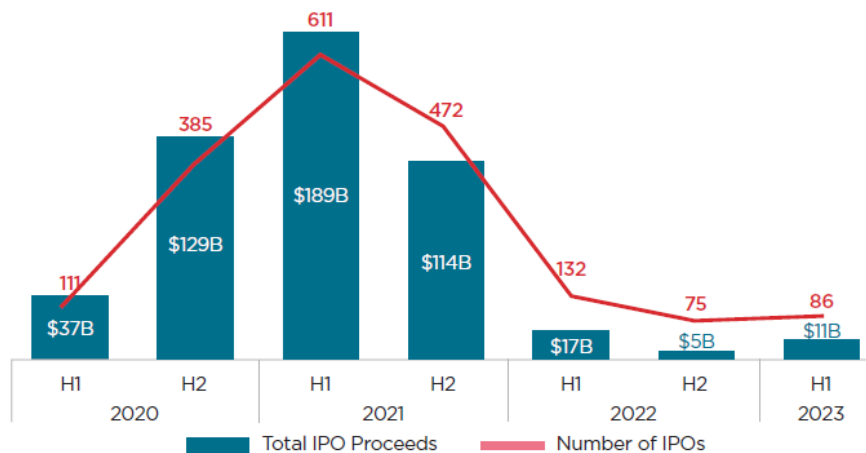
2023 Capital Formation Trends

The Federal Reserve’s March 2023 Report on Employer Firms found that 94% of small businesses experience financial challenges in accessing capital to build their companies.¹ Some recent statistics on these challenges:

- 90% of new businesses with employees need external credit at the start.²
- More than 50% of small businesses seeking capital needed less than \$50,000.³
- 55% of small business owners found it harder to access capital than in prior years.⁴
- 3.7 times more startups failed in 2022 due to lack of financing or investors than in 2020.⁵

Initial Public Offerings (IPOs)

The volume and number of IPOs have fallen significantly since their peak in the first half of 2021. IPOs by small companies have been relatively stable; the decrease is primarily due to a sharp reduction in special purpose acquisition company (SPAC) and large company offerings.



Source: Office of the Advocate for Small Business Capital Formation, Annual Report Fiscal Year 2023

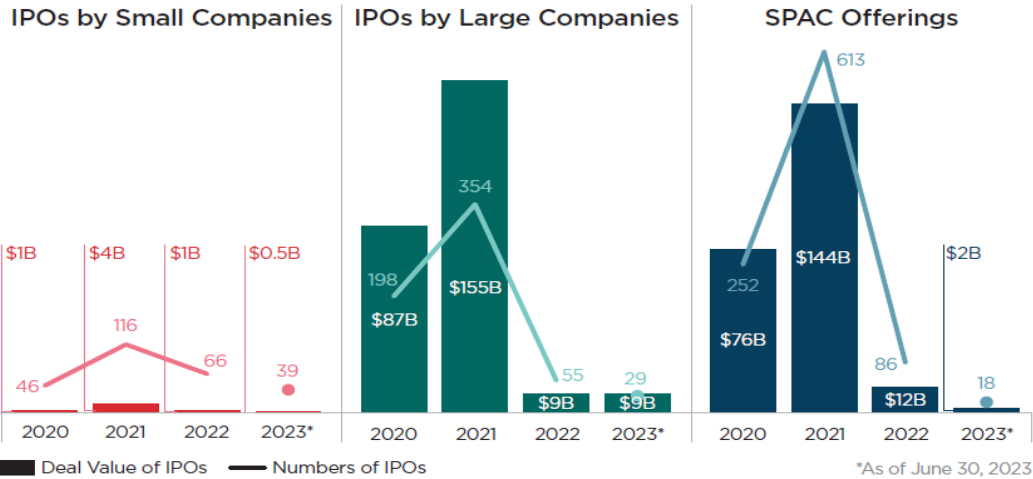
¹ “2023 Report on Employer Firms: Findings From the 2022 Small Business Credit Survey,” fedsmallbusiness.org, 2023.

² “Access to Capital for Entrepreneurs: Removing Barriers,” kauffman.org, June 2, 2023.

³ Reimagine Main Street, “Trust & Access to Capital,” irp.cdn-website.com, June 12, 2023.

⁴ Small Business Majority, “Opinion Poll: Small Businesses Share Concerns With Recent Banking Closures, Access to Capital Challenges,” smallbusinessmajority.org, May 3, 2023.

⁵ “Why Startups Failed in 2022,” skynova.com.

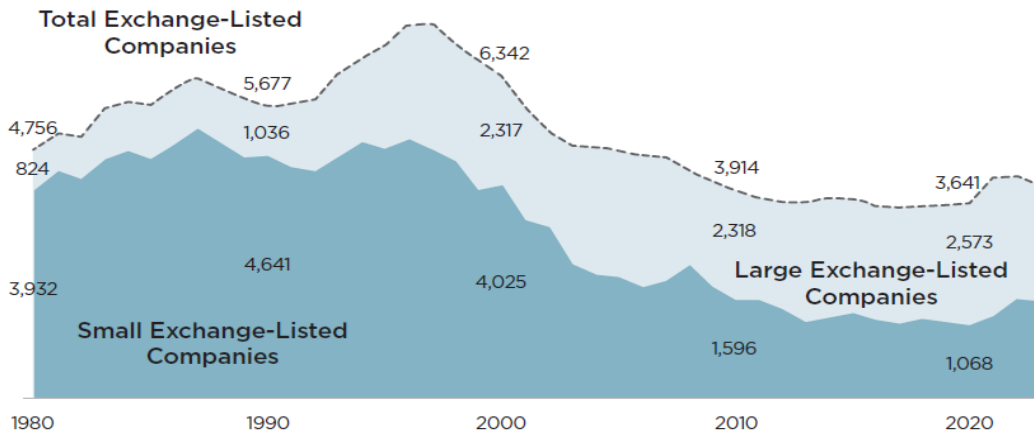


Source: Office of the Advocate for Small Business Capital Formation, Annual Report Fiscal Year 2023

On January 24, 2024, the SEC issued a final rule on SPACS. The rules would better align requirements for de-SPAC transactions and IPOs and enhances investor protections. The final rule included some of the OAS suggestions on safe harbors and elimination of hard timeframes. It is likely that the number of SPAC transactions will continue to decline,

Small Public Companies

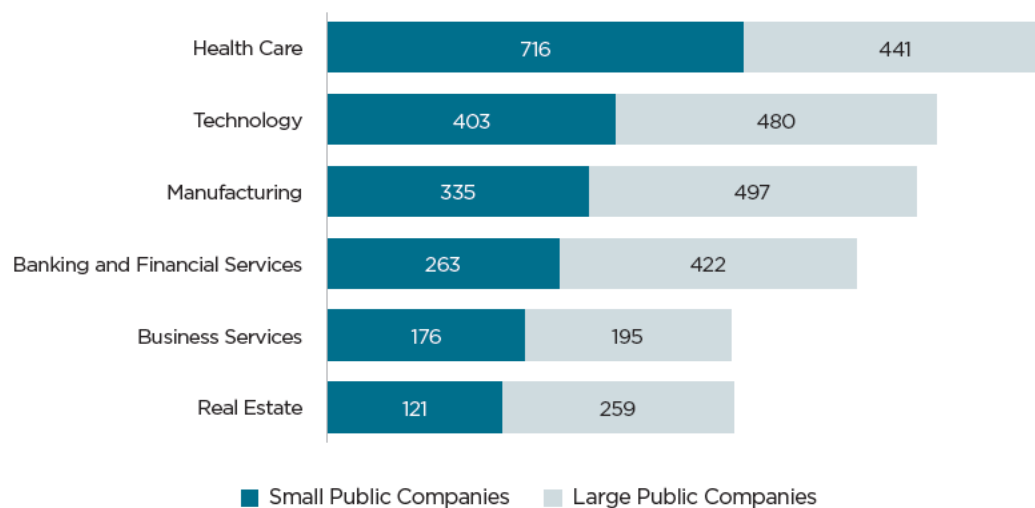
The number of exchange-listed companies has declined from a peak of more than 8,000 in 1996 and small exchange-listed companies (less than \$250 million market capitalization) account for most of the decrease.⁶ The aggregate market capitalization of small exchange-listed companies also has declined.



Source: Office of the Advocate for Small Business Capital Formation, Annual Report Fiscal Year 2023

⁶ USA: Listed Companies, theglobaleconomy.com.

Top Industries of Small Public Companies Based on Number of Companies



Source: Office of the Advocate for Small Business Capital Formation, Annual Report Fiscal Year 2023

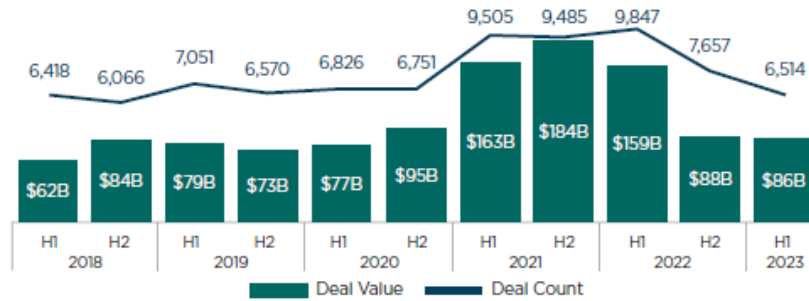
Exempt Offerings

Companies are electing to stay private longer for several reasons, notably cost, increasing regulation and disclosure requirements, market volatility, and pressures for stable quarterly results. Private placements are unregistered, nonpublic securities offerings that rely on an available exemption from SEC registration. On an annual basis, the amount of capital raised in exempt offerings is twice the size of registered offerings. Regulation D is the most frequently used pathway to raise capital from investors and works well for companies that have access to accredited investors.

See the [Appendix](#) for market size and a summary of exempt offerings.

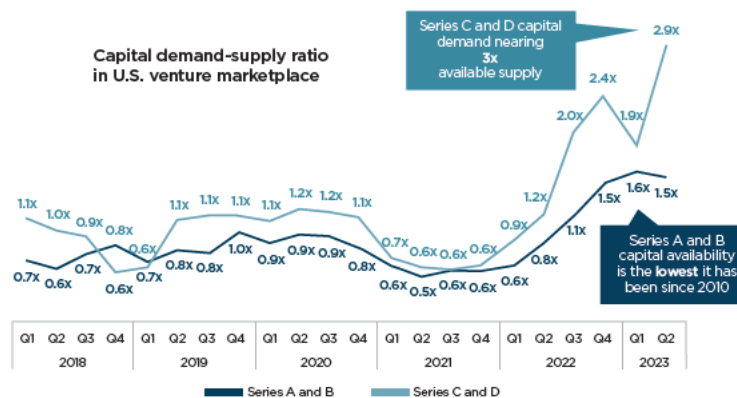
Venture Capital (VC)

Mature and later-stage businesses are generally looking for larger amounts of capital to fund operations, develop new product lines, or prepare for public markets. Capital for these businesses frequently comes from VC funds. While VC activity is still primarily concentrated in California, New York, and Texas, it is beginning to spread slowly to startups across the United States. These top three states accounted for 63% of VC deal value in 2022, a 12% decrease from 2020. Following historically high investment activity in 2021 and the first half of 2022, deal counts and investment volume have fallen closer to pre-2021 figures. VC fundraising has slowed from the record highs of 2021 and 2022 and is on pace to set a six-year low. The first half of 2023 saw a 73% decrease in funds raised compared to 2022. However, over the past five years, the amount of capital that VCs have ready to invest—dry powder—has continued to increase to \$280 billion at the end of 2022. There was a 90% reduction in portfolio company exits in 2022 compared to 2021, which reduces distributions and reinvestment into new VC funds.



Source: Office of the Advocate for Small Business Capital Formation, Annual Report Fiscal Year 2023

The need for capital in early-stage and later-stage VC deals exceeds the available supply.



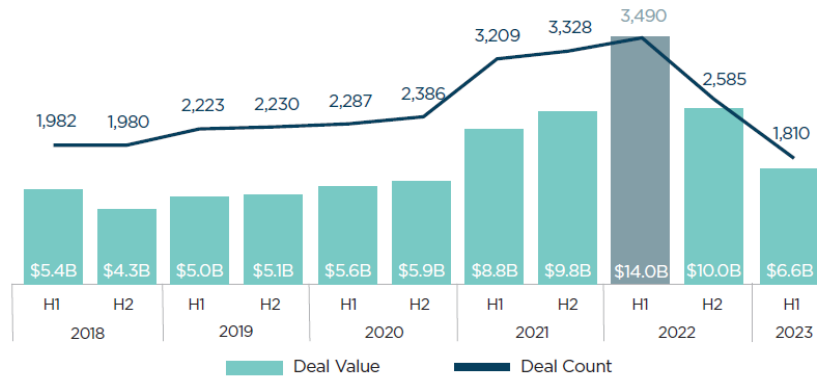
Source: Office of the Advocate for Small Business Capital Formation, Annual Report Fiscal Year 2023

Angel Investors

The angel investor market retracted in 2022. According to the Center for Venture Research at the University of New Hampshire, total angel investments in 2022 were \$22.3 billion, a decrease of 23.7% from 2021.⁷ A total of 62,325 entrepreneurial ventures received angel funding in 2022, a decrease of 9.8% from 2021. Deal size for 2022 decreased by 15.4% to \$356,650. On a more positive note, the number of active investors in 2022 increased 1.2% to 367,945. For the third consecutive year, the seed and startup stage market was the predominant investment stage for angels.

A pre-seed or seed round is typically a company's first funding round and is often used for product development and market research. This round may include funding from friends and family, angel investors, or early-stage funds. Seed activity has slowed in both overall deal value and count from its peak in the first half of 2022.

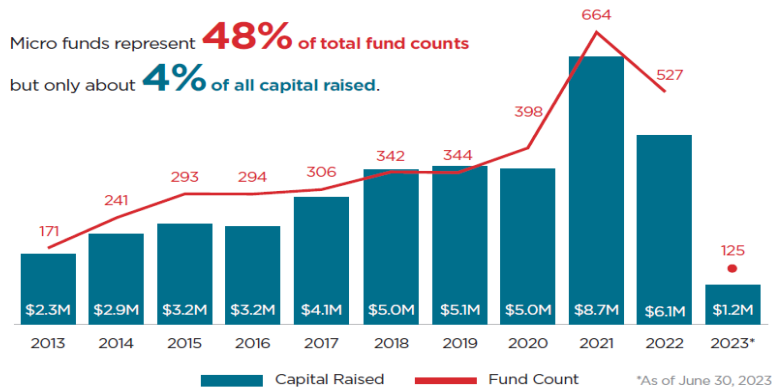
⁷ "The Angel Market in 2022: The Rising Impact of Women Angels," paulcollege.unh.edu, May 20, 2023.



Source: Office of the Advocate for Small Business Capital Formation, Annual Report Fiscal Year 2023

Micro Funds

A micro fund is a fund that raises \$50 million or less and has been an increasing source of seed funding.



Source: Office of the Advocate for Small Business Capital Formation, Annual Report Fiscal Year 2023

OAS Recommendations

Small Public Companies

As noted in the summary statistics above, while market capitalization and profits for exchange-listed public companies thrived, the market capitalization of small companies has continued a long-standing, steady decline. This indicates small companies are not receiving the same benefits of being public. The AOS has the following recommendations:

- Harmonize the frameworks governing smaller reporting company (SRC) and accelerated filer definitions by aligning the SRC and non-accelerated filer categories. This alignment would allow all SRCs to enjoy all the benefits of being non-accelerated filers—namely the exemption from the auditor attestation requirement under Section 404(b) of the Sarbanes-Oxley Act.
- When considering new disclosures for public companies, scale those obligations and delay compliance for small public companies. Delaying compliance for small public companies helps to promote better initial disclosure for those

companies. Small public companies will benefit from seeing the disclosures that large public companies prepare in response to similar new requirements.

Accredited Investor Definition

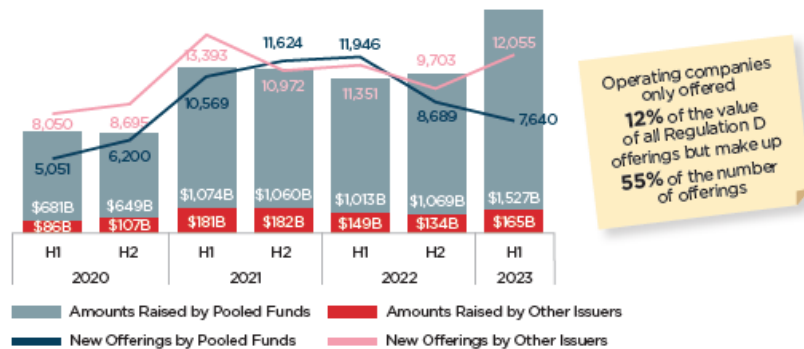
The SEC’s most recent regulatory agenda continues to indicate it will consider updates to the accredited investor definition.⁸ The Dodd-Frank Act also requires the SEC to review the accredited investor definition at least every four years to determine if any adjustments are required; the last update was in August 2020. The OAS notes that any changes that would decrease the pool of accredited investors would negatively impact small business capital formation, especially for first-time founders. OAS carried forward the following recommendations from its 2022 report:

- Expand the definition to include additional qualitative professional criteria and offer more opportunities to demonstrate financial sophistication as an alternative to the income and net worth thresholds.
- Consider the impact any change to the income and net worth thresholds would have on minorities and populations located in rural areas.

Regulation D (Reg D) & Form D

The SEC’s most recent regulatory agenda continues to indicate it will consider updates to Reg D and Form D. Both companies and investors feel that Reg D works well for companies with access to accredited investors and is the most frequent pathway to raise capital.

New Regulation D Offerings



Source: Office of the Advocate for Small Business Capital Formation, Annual Report Fiscal Year 2023

In evaluating the role of the accredited investor definition in Reg D offerings, 81% of Reg D offerings were by 3(c)(7) funds⁹ that would not be affected by an updated accredited investor definition. The accredited investor definition is far more relevant for 3(c)(1) funds, which accounted for only 4% of all offerings under Reg D. OAS recommends:

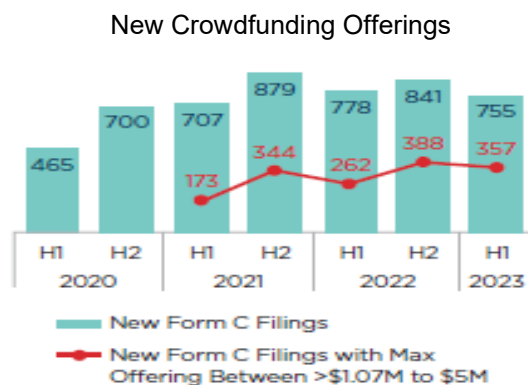
⁸ An investor who meets certain standards outlined in Rule 501(a) of Regulation D qualifies as an accredited investor. For example, individuals may qualify by having (1) annual income exceeding either \$200,000 (singly) or \$300,000 (with spouse or spousal equivalent) in each of the two most recent years; (2) more than \$1 million in net worth, excluding the primary residence (singly or with spouse or spousal equivalent); or (3) certain financial professional credentials. Qualifying as an accredited investor determines whether an investor can invest in businesses conducting common types of exempt offerings.

⁹ A 3(c)(7) fund is a pooled investment vehicle that is excluded from the definition of investment company in the Investment Company Act because it is limited to investors who are qualified purchasers and otherwise meets criteria outlined in §3(c)(7) of the Investment Company Act.

- Do not make the Form D notice and associated requirements more burdensome, especially for smaller operating companies raising smaller amounts of capital.
- The SEC should separately assess amounts raised by operating companies and pooled funds.
- Amounts raised by 3(c)(7) funds should be excluded, as investors in those funds must be “qualified purchasers,”¹⁰ a much higher standard than the accredited investor definition.

Regulation Crowdfunding

Crowdfunding enables a company to raise capital from its local community, brand or product loyalists, and other non-accredited investors. This pathway is especially attractive for small companies located outside traditional capital hubs (New York, San Francisco, or Austin). Seventy percent of crowdfunding capital is now as distributed outside the top 10 capital hubs.



Source: Office of the Advocate for Small Business Capital Formation, Annual Report Fiscal Year 2023

Market participants note the cost and existing reporting requirements for raising small dollar amounts through Regulation Crowdfunding can be a deterrence. For example, the requirements to have financial statements reviewed by an independent public accountant delay the ability to commence an offering and impose a significant upfront cost without a guarantee of a successful offering. The OAS recommends the following improvements:

- Allowing flexibility in the type of accounting a company uses for small businesses raising up to \$500,000.
- Increasing the offering size threshold under which an issuer may meet its financial statements requirements by providing financial statements and income tax return information certified by the principal executive officer.
- Congress should amend §4A(f)(3) of the Securities Act to modify the provision that prohibits investment companies from using the Regulation Crowdfunding exemption.

VC & Emerging Fund Managers

Founders looking to raise smaller, earlier rounds report challenges and decreasing interest from VC funds. The percentage of capital investment with emerging fund managers who tend to have smaller funds and write smaller checks dropped to a new decade low.

¹⁰ An individual, married couple, family office, or trust is a qualified purchaser if they have \$5 million or more in investments or joint investments. An investment manager qualifies if they manage at least \$25 million in investments for other qualified purchasers.

OAS carried forward the below recommendations from its 2022 report. The SEC has the authority to amend the “venture capital fund” definition in the *Investment Advisers Act of 1940*, but Congress would need to act to amend the beneficial owner limit and “qualifying venture capital fund” definition in the *Investment Company Act of 1940*.

- Amend the “venture capital fund” definition in Rule 203(l)-1 of the *Investment Advisers Act of 1940* to treat VC funds’ investments in other VC funds as “qualifying investments.” This would allow these investments to be excluded from the 20% nonqualifying basket limit. A fund of funds model would permit larger funds to invest in smaller funds—managed by emerging managers—that write smaller checks, potentially unlocking capital otherwise earmarked for later-stage companies to be reallocated to early-stage companies.
- Increase the current 100 beneficial owners limit for funds that rely on the exemption in §3(c)(1) of the *Investment Company Act of 1940*. This limit makes it difficult for emerging fund managers—who may not have access to a network of investors who can write large checks—to raise sufficient capital.
- Increase the limit on investors in—and expand the \$10 million maximum size of—the “qualifying venture capital fund” exemption in §3(c)(1) of the *Investment Company Act of 1940*. A qualifying venture capital fund can have no more than \$10 million from no more than 250 investors. Raising the \$10 million limit would improve the exemption’s utility by allowing for a diversified portfolio of investments and the fund’s operating costs. Expanding the \$10 million cap and the related 250 investor limit would equip emerging managers to raise a meaningful-sized fund while covering their expenses.

SEC Proposals

The SEC’s Small Business Capital Formation Advisory Committee (SBCFAC) provides advice and feedback to the SEC on commission rules on potential impacts to small business capital formation.

Climate Disclosure

The SBCFAC provided the following feedback to the SEC on the March 2022 climate disclosure proposal for registrants. The SEC’s most recent regulatory agenda indicates this could be finalized by April 2024.

- Provide a more detailed cost-benefit analysis, including the impact that the proposal would have on smaller public and private companies.
- Scale and delay the compliance requirement for emerging growth companies and SRCs.
- Expand the safe harbor for liability for Scope 3 emissions disclosures to include all climate-related disclosures.
- Eliminate the attestation requirement, as it would be costly and burdensome, and it will delay reporting. Instead, require the information to be furnished rather than filed.
- Tailor the requirements for certain industries.
- Re-evaluate the timing for filing climate-related disclosures since the information may not be available in time for a company’s annual report on Form 10-K.
- Provide a longer implementation time frame for the new rules so that smaller companies would have more time to transition, work through implementation, and comply with the new requirements.
- Consider incentives for companies that are providing climate-related disclosures, rather than penalties for noncompliance.
- Consider how the climate-related disclosure requirements may deter private companies from going public. There should be a pathway for very small companies to become public reporting companies without hiring expensive climate-related consultants.
- Consider the rule’s impact on small companies that are suppliers or vendors for public companies. To the extent public companies are required to track and provide downstream greenhouse gas emissions, smaller suppliers and

vendors that are unable or delayed in providing their greenhouse gas emissions may lose business to larger companies that can provide such metrics. Due to disadvantages arising from lack of resources and smaller operations scale, both small public and private companies may face greater challenges in accessing capital and generating revenue they need to sustain their businesses.

Resource: [SEC's ESG Climate Proposal – What You Need to Know](#)

Conclusion

Whether you are an accelerated filer or a fast-growing company thinking about going public, **FORVIS** can help you navigate the ever-changing accounting and reporting landscape. The assurance team at FORVIS delivers experience and skilled professionals to help align with your objectives. Our proactive approach includes candid and open communication to help address your financial reporting needs. At the end of the day, we know how important it is for you to be able to trust the numbers; our commitment to independence and objectivity helps provide the security and confidence you desire. FORVIS works with hundreds of publicly traded companies in the delivery of assurance, tax, or advisory services, within the U.S. and globally. For more information, visit forvis.com.

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Appendix – Summary of Exempt Offerings

Source: Office of the Advocate for Small Business Capital Formation, Annual Report Fiscal Year 2022 & 2023

Summary of Exempt Offerings			
Exemption	Description	Capital Raised July 1, 2021– June 30, 2022	Capital Raised July 1, 2022– June 30, 2023
Rule 506(b) Private Placements	Companies can raise unlimited capital from investors with whom the company has a relationship and who meet certain wealth thresholds or have certain professional credentials. A company cannot use general solicitation in a 506(b) private placement.	\$2.3 trillion (\$1.3 million median)	\$2.7 trillion (\$1.2 million median)
Rule 506(c) General Solicitation Offerings	Companies can raise unlimited capital by broadly soliciting investors who meet certain wealth thresholds or have certain professional credentials.	\$148 billion (\$800,000 median)	\$169 billion (\$750,000 median)
Rule 504 Limited Offerings	Companies can raise up to \$10 million in a 12-month period, in many cases from investors with whom the company has a relationship.	\$624 million (\$250,000 median)	\$258 million (\$250,000 median)
Regulation Crowdfunding	Eligible companies can raise up to \$5 million in investment capital in a 12-month period from investors online via a registered funding portal.	\$368 million (\$100,000 median)	\$352 million (\$100,000 median)
Intrastate Offerings	Allow companies to raise capital within a single state according to state law. Many states limit the offering to between \$1 million to \$5 million in a 12-month period.	Not available	
Regulation A Offerings	Eligible companies can raise up to \$20 million in a 12-month period in a Tier 1 offering and up to \$75 million in a 12-month period in a Tier 2 offering through a process similar to—but less extensive than—a registered offering.	\$1.8 billion (\$2.2 million median)	\$1.5 billion (\$1.6 million median)
Rule 701 Employee Benefit Plans	A company can sell at least \$1 million of securities under this exemption—regardless of its size—to compensate employees, consultants, and advisors. These are restricted securities and may not be freely traded unless the securities are registered, or the holders can rely on an exemption.	Not available	Not available
Regulation S Rule 144a	Regulation S provides that offers and sales of securities that occur outside of the U.S. are exempt from the registration requirements of §5 of the <i>Securities Act of 1933</i> .	\$2 trillion (breakout not available)	\$1.3 trillion (breakout not available)
Rule 144a	Rule 144A provides a safe harbor exemption to the sellers which can be used for reselling securities to the qualified buyers and allows institutions to trade these securities among themselves, avoiding a registration process under §5 of the <i>Securities Act of 1933</i> .		