How to Support Entrepreneurial Businesses

Early-stage companies require capital to grow and develop. While specialized investors such as venture capitalists (VCs) and business angels are a source of capital for private entrepreneurial companies, VC capital is not easy to attract. In Canada, the Toronto Venture Stock Exchange (TSX-V) provides an alternative avenue through which growth-oriented firms can access public venture capital on a regulated junior equity exchange. The TSX itself notes that companies listed on the TSX-V are provided with the opportunity to gain a solid foothold in the public market, with the potential to work towards graduation to the senior TSX.

In a recent paper, my co-authors Michele Meoli, Michael Robinson, Silvio Vismara and I study whether the TSX-V is an effective incubator market for developing firms by comparing the long-run stock performance of firms that graduated from the TSX-V to the senior TSX against the performance of VC-backed companies that had a direct IPO on the TSX.[1] While the literature touts the value-added support provided by a VC, we suggest that there are several reasons why we might expect TSX-V graduations to the TSX to outperform VC-backed IPOs. First, managing a public company is very different from managing a private company, and there is often a steep learning curve for newly public companies. Thus, listing first on the TSX-V provides the management team with invaluable experience on how to operate a public company, such as interacting with various public market stakeholders, including shareholders, analysts, regulators, and the media. Second, the TSX-V listing and governance requirements are slightly relaxed versions of those on the TSX, such that the transition for the management team and board from the TSX-V to the TSX is rather seamless.

Our results support the notion that the TSX-V provides important learning opportunities and experience for growing firms. In particular, over the test period 2000-2014, we find TSX-V graduations on average outperform VC-backed IPOs by about 30 percentage points in the three years following the TSX listing on a market-adjusted basis.

> "OUR RESULTS SUPPORT THE NOTION THAT THE TSX-V PROVIDES IMPORTANT LEARNING OPPORTUNITIES AND EXPERIENCE FOR GROWING FIRMS."

The above results are particularly insightful given the experiences of junior public equity markets in other countries. Interestingly, a number of European countries have also set up junior exchanges, but with little success. Research indicates that IPOs on these exchanges have performed poorly relative to IPOs on senior markets and very few firms graduate from the junior to the senior markets.

The success of the TSX-V documented in the above study complements some of my prior work. In a book chapter co-authored by Michael Robinson and I, we show that the number of firms going public on the TSX-V is substantially higher than the number of IPOs in other junior markets.[2] We further document that the participants on the TSX-V are mostly retail investors, while the junior exchanges in other countries mainly attract institutional investors, and as a consequence lack liquidity, which we argue is an important determinant of a viable junior equity market.

In another study, my co-author Michael Robinson and I examine the TSX-V's Capital Pool Company (CPC) program, which is a highly regulated blind pool program.[3] We show that unlike the blind pool experience in the U.S., where significant fraud was followed by the adoption of regulations that effectively shut down that market, the Canadian regulations, which encompass VC-like governance mechanisms and the participation of high-quality underwriters, balance the capital needs of early-stage entrepreneurial firms, while still serving to protect the interests of investors.

1 "Can Spending Time in the Minors Pay Off?" An Examination of the Canadian Junior Public Equity Markets", 2018, *Journal of Small Business Management,* 56, pp. 88-107.

2 "The Canadian Junior IPO Market and the Capital Pool Company Program", 2013, in Mario Levis and Silvio Vismara (Eds.), *Handbook of Research on IPOs*, London: Edward Elgar, pp. 124-140.

3 "Is Effective Junior Equity Market Regulation Possible?", 2014, Financial Analysts Journal, 70 (4) pp. 42-54.

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BIOGRAPHY

DR. J. ARI PANDES is an Associate Professor of Finance at the University of Calgary's Haskayne School of Business. He teaches courses at the PhD, Executive MBA, MBA, and senior undergraduate levels, as well as to corporate executives. Dr. Pandes holds a Ph.D. in Finance from the Schulich School of Business at York University, a Master's in Economics from York University, and a Bachelor of Commerce from the University of Toronto.

Dr. Pandes' research focuses primarily on issues in empirical corporate finance, entrepreneurial finance, and law and finance, with specific interests in securities offerings, investment banking, and financing decisions. He has presented his research at top international Finance conferences, at various universities internationally, and at the U.S. Securities and Exchange Commission and the Bank of Canada.

Dr. Pandes has also been awarded research grants from the Social Sciences and Humanities Research Council (SSHRC), the Canadian Securities Institute Research Foundation, and the University of Calgary. His research into the Canadian capital markets has twice won the Bank of Canada best paper award, as well as the 2016 CFA Society Toronto and Hillsdale Canadian Investment Research Award.

Dr. Pandes' research has been cited in the press, and he frequently provides financial and economic insights to various media outlets.

TESTIMONIAL

It has been a great honour to receive funding from the Canadian Securities Institute Research Foun-dation. The funding has allowed me to conduct research that I otherwise would not have had the resources to complete. In particular, my research agenda focused largely on Canadian data, which is often not readily available and requires extensive hand-collection. The research funds through the CSI Foundation have allowed me to work with research assistants and create the databases neces-sary for my research. During this process, the research assistants (who are students) also learned a great deal about the research process. The fruits of the Foundation's support are already evident, as one of the papers that came out of my research agenda won the 2016 CFA Society Toronto and Hillsdale Canadian Investment Research Award, and was recently published in the *Journal of Small Business Management*. The Foundation's support will truly provide an impact in addressing access to capital issues in the Canadian capital markets, while also contributing to the academic literature.