September 9, 2014

The Quiet Decline of Canada's IPO Markets

Written by: Bryce Tingle

The Toronto Stock Exchange's parent company has been travelling the country raising the profile of its new venture, TSX Private Markets. At the same time, Canada's securities commissions are engaged in the most comprehensive overhaul of the private placement regime in more than a decade. In Ontario, in particular, this would reverse the increasingly restrictive trends of previous reforms and liberalize its private capital markets.

This is a curious state of affairs. The TSX is chipping away at the incentives for a company to go public and the Ontario Securities Commission (OSC) is making it easier for companies to raise money outside of its regulatory "gold standard": the public company prospectus system. What is going on?

Canada's public markets are failing to do their job of supplying capital to innovative businesses in this country. Canada is uniquely dependent on its public markets. We have the largest number of public companies relative to our population in the world – more than double the next highest country (and four times higher than the United States). But our Initial Public Offering (IPO) market has been collapsing for over a decade.

Research published in the most recent issue of the *Canadian Business Law Journal* by Ari Pandes, Michael Robinson and myself, sets out, for the first time that we are aware of, an analysis of the rate operating businesses have been going public in Canada since statistics became readily available in 1993. Between 1993 and 2000 there were an average of 42.6 IPOs on the TSX each year; following 2000 the average was 18.2 IPOs a year – less than half. Even when the markets were awash in liquidity and commodity prices climbed sharply, TSX IPOs in the best years of this century never exceeded the *average* rate of the previous decade and only amounted to 40% of its best year.

The decline becomes even more visible when the inflation-adjusted proceeds of IPOs over the past two decades are examined. Both in absolute terms and as a percentage of Gross Domestic Product (GDP), the IPO market of the 1990s was in significantly better health than at any time in the years since then. The best year this century for IPOs was 2010, which generated proceeds equal to 0.28% of GDP – or just over half of the proceeds generated during any one of several years in the 1990s.

Reference to the dot-com boom and bust, and then the 2008 financial crisis, provide little assistance in explaining these statistics. The Canadian market is largely resource-driven, not particularly oriented towards technology stocks. Low commodity prices in the second half of the 1990s likely explains why this country's IPO rates actually declined, even as the United States IPO market developed a bubble. Similarly, Canada's IPO market was only comparatively briefly impacted by the 2008 crisis, with 2010 being the best year for IPOs in the past decade.

The United States has convened congressional hearings (see here and here) and blue-ribbon panels (see here, here and here) to look into the causes of the decline in public companies in that country. Canada has done nothing. But the fact that we are experiencing the same kind of decline as the United States makes us an important part of any analysis of the problem. The most common explanation in America for the decline in IPOs is the cost of complying with Sarbanes-Oxley era regulation – but Canada did not import most of this regulation and avoided, in particular, the most expensive requirements such as the auditing of financial controls.

Other common American explanations for the decline of IPOs, such as America's toxic litigation climate (see here and here), changes in the benefits conferred by scale in the high-tech industry, or alterations to the market structure affecting investment banks (see here and here), also run afoul of the Canadian counterfactual.

We are left with the simplest of all explanations: the public markets have become much less congenial to business. Spend any time in Canada's boardrooms these days and you will hear the same message. Whereas there were once incentives to management teams to take their companies public, there are now incentives to avoid the public markets if at all possible. The result is a climbing cost of capital, less transparency and fewer investment opportunities for a Canadian middle class increasingly responsible for its own retirement.

Professor Edward J. Waitzer, has recently argued for a comprehensive review of Canada's capital markets by our securities regulators to ensure we are working on our most urgent priorities as a country. I second the motion.

An earlier version of this comment appeared in the National Post.

To subscribe to ABlawg by email or RSS feed, please go to **http://ablawg.ca**
Follow us on Twitter **@ABlawg**