

EFFECTIVE JUNIOR EQUITY MARKET REGULATION

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ABSTRACT

Entrepreneurial firms face significant difficulties when raising equity capital. Public equity markets that might represent a significant source of capital have been relatively inaccessible, and past programs designed to facilitate this access have been unsuccessful. Programs that do not account for the special financing needs of entrepreneurial firms have performed poorly. In this paper, we study Canada's Capital Pool Company (CPC) program, a program that since late-1986 has been helping high-risk small firms access public equity markets. On the surface, the program is similar to U.S. blind pool programs which were subject to a number of frauds during the 1980s. In Canada, the first blind pools in 1986 experienced a high level of fraud and in response to this fraud the CPC program was developed. Under this program, VC-like governance mechanisms are placed on the firm's founders, and significant regulations are placed on the firm's underwriters, in an attempt to increase the quality of firm founders and to provide protection to investors. This study documents how the program has expanded over time from being based solely in one province in Canada to being adopted by regulators, issuers, and investors from many jurisdictions. In addition, we provide evidence that the quality of firms using the program to raise capital has been increasing over time and the incidence of fraud in this marketplace has been declining as a result. Quality of firms is measured by the ability of the firms: to become regularly listed firms, to have success as regularly listed firms, and to graduate to a more senior exchange. We also document an increase in the quality of the underwriting firms supporting CPC IPOs. Overall, our empirical analysis shows how the adoption of the CPC regulations created a program that has proven successful for both investors and issuers. This analysis supports the premise that it is possible to develop effective regulations in junior equity markets that will serve to minimize the likelihood of fraud in those markets.

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1. Introduction

When Delaware Internet-based ePals Corporation (“ePals”) decided to go public in the summer of 2011, it did so by way of a Reverse Takeover (RTO) of a micro-cap blind pool on the TSX Venture Exchange (TSXV). ePals was an education technology and safe social learning network firm with a savvy management team, strategic partnerships with leading US firms including IBM and Microsoft, and a customer base of 700,000 educators and millions of students in around 200 countries. Why would a much larger US private firm choose to go public by taking over a Canadian blind pool with less than \$1 million in cash?

This transaction reflects a realization that the TSXV’s Capital Pool Company (CPC) program has been providing an effective method for firms to go public for over 25 years. The CPC program began in 1986 as a regulatory response to fraudulent business practices with respect to Canadian blind pools. Similar problems were experienced in the US capital markets during this time period and the different responses of the Canadian and US regulators provide a natural experiment with respect to regulations designed to protect investors in the penny stock marketplace. In Canada, a combination of effective due diligence during the IPO process, and effective governance once a firm had gone public, allowed the CPC program to overcome the problems with fraud prevalent in junior equity markets. In addition, the CPC program has resulted in a number of major successful outcomes for both the issuing firms and their investors. For example, the founders of Boardwalk Equities, a real estate and property management firm, invested \$75,000 of their own capital and created a CPC shell by raising an additional \$200,000 in the public equity market in January of 1994. By the end of 2004 Boardwalk was listed on the New York Stock Exchange with assets of \$1.809 billion, revenues of \$282.5 million, and an equity base of \$385.5 million. As well, Boardwalk shareholders had experienced a price appreciation of 7,280% from the firm’s IPO price of \$0.25. More recently, Celtic Exploration Inc., which started with \$700,000 in capital as a \$0.25 per share CPC in 2002, received a takeover offer of \$24.50 per share in October 2012 which valued the firm at \$3.1 billion.

The purpose of this paper is to identify the factors that have allowed the CPC program to overcome many of the problems, including fraud, that have been experienced in other junior

equity markets. In Section 2, we will review some of the theoretical problems associated with raising capital by small equity firms and document the level of fraud that exists in junior and more senior equity markets. Section 3 will provide a theoretical perspective on possible solutions to the problems of junior equity markets and will review the regulatory responses in the US and Canada to the problems of penny stock fraud. This section will also develop a series of propositions with respect to the Canadian regulatory responses that will be empirically tested in this study. In Section 4, we will review the sources of data used in the study and conduct an analysis of the Canadian CPC program by examining its impact on the incidence of fraud and other problems with junior equity offerings. Section 5 will provide conclusions and recommendations for further study.

2. Public Equity Financing of Junior Firms

2.1. Theoretical Financing Constraints

Investors in entrepreneurial firms generally face three types of investment risk: market, agency, and liquidity. As discussed by Fiet (1995) and Wright and Robbie (1998), market risk denotes a broad class of uncertainty: capability to develop viable products, customer demand once the product is developed, the speed with which customers adopt the firm's products, and the nature of market competition.

Agency uncertainty results from information asymmetry between the firm's management and its key investors. Information asymmetry has two dimensions: adverse selection and moral hazard. Adverse selection means that the wrong firms come to the markets looking for capital. Thus, for investors poor quality projects are overrepresented in the small firm equity marketplace. The second aspect of informational asymmetry, moral hazard, is the way that outside investment changes the behavior and incentives of the entrepreneur. As discussed by Jensen and Meckling (1976) and Sood (2003), entrepreneurs may act differently after outside investors have contributed capital than if they had invested their own funds. The adverse selection and the moral hazard problems combined create significant agency risk for outside investors. A key issue to examine is whether effective regulation of junior firms can help overcome some of these agency issues to provide protection to investors, but also allow the credible firms the ability to raise development capital.

2.2. Europe's Experience with Second-Tier Markets

The development of a viable second-tier market for small firms is a key goal of many stock exchanges around the world. As reported in Vismara, Paleari and Ritter (2012), the major stock exchanges in Europe's four biggest countries have launched a total of eleven second-tier markets since 1995 and Nasdaq established a European market in the later 1990s. They note, however, that the Nasdaq European market failed to attract many listings and only five of the European second-tier markets were still in existence in 2011.

Some of the issues associated with these markets is that they are exchange-regulated, with minimal regulations, and with most IPOs the shares are offered exclusively to institutional investors. While the firms using these markets are able to raise several million Euros, they rarely are able to develop a liquid market for their shares and have much worse post-IPO performance than regular IPOs on the same markets. Overall, the number of firms raising capital using these European second-tier markets has declined significantly in recent years.

2.3. Fraud in Junior Equity Markets

Regulators overseeing a junior equity market face the conflicting objectives of protecting the interest of investors while not creating a regulatory burden that is too expensive or cumbersome for the firms seeking to raise capital from those investors. Achieving the appropriate balance proved to be a difficult exercise in the United States. As noted in Riemer (2007), securities fraud in the US increased significantly in the 1980s, particularly in the penny stock market, and investors suffered billions of dollars in losses. Many of the penny stock firms were started using a blind pool, or blank check, form of financing.¹ A 1986 study of sixty-eight US blind pools found that only twenty-three, or 33.8%, were trading at a price above the initial subscription price, and one blind pool underwriter estimated that only 2% of these pools would ultimately become successful (see Stern and Bornstein (1986)).

Canada's experience with blind pools began in the province of Alberta in 1986, at a time

¹ Heyman (2007, p. 534) notes that many US securities regulations and media reports do not distinguish between the blind pool and blank check form of offering even though there are significant differences in some instances. For purposes of this paper, we will use the term blind pool and blank check interchangeably to refer to an investment situation in which a shell firm has no existing business activities or contracts in place when it goes public. The IPO proceeds will be used to purchase assets or an existing business to turn the shell into an operating company.

when falling energy prices had caused traditional financing to dry up for the junior energy firms which formed an important part of the province's economic base. Between April and July a small regional investment dealer took seven firms public as blind pools. The principals of the second such firm, Audit Resources Inc., engaged in fraudulent trading practices which had the effect of increasing the firm's share price from \$0.05 to \$8.00 over a few months before regulators intervened and the fraud was discovered. Not only did investors lose money, but employees of the investment dealer got caught up in the fraudulent dealings and the investment dealer was permanently shut down later that year. By the time these problems with the program became apparent to the securities regulator, the Alberta Securities Commission (ASC), a further 14 blind pools had gone public. As discussed later in this paper, almost 20% of these early Canadian blind pools were investigated for fraud during the first eight months of the program's existence and in half of the cases the firm's principals were found guilty of fraudulent behaviour. In addition, only eight of the 21 (38.1%) blind pools turned into successful firms.

To establish a benchmark for fraud in junior markets, it is useful to examine studies of fraud in other markets. Beasley et. al. (2010) investigated US fraudulent financial reporting by examining SEC Accounting and Auditing Enforcement Releases (AAERs) between 1998 and 2007. Their study identified 347 cases of such fraud out of a population of 9,428 US public companies enumerated in 2006 (SEC (2006)) for a financial fraud percentage of 3.68% over this 10 year period, or approximately 0.37% per year. In a more recent study, Cumming and Johan (2012) document cases of fraud (their study include all types of fraud, not just financial fraud) investigated by securities regulators in the US, Canada and the UK over the period January 2005 to June 2011. They report average annual fraud (ignoring delinquent filings) of 1.83% for NYSE firms, 4.41% for NASDAQ firms, 1.99% for US pink sheets, 0.33% for Canadian TSX firms, 0.10% for Canadian TSX Venture firms, 0.38% for UK LSE firms, and 0.10% for UK AIM firms. They attribute the relatively lower level of fraud investigations in Canada and the UK to lower levels of enforcement in those countries.

2.4. Liquidity Risk in Junior Equity Markets

MacIntosh (1994) notes that there exists a "catch-22" in the development of a market for junior equities. Primary offerings in such a market are not likely to be successful unless there is

some assurance that there will be an active secondary market following the initial listing. Unfortunately, an active secondary market for such securities cannot develop until there have been successful primary offerings in the market.

Further complicating the issue is the fact that the large underwriting firms in a country are unlikely to be interested in participating in junior equity issues. For example, in the US, Wolfe, Cooperman and Ferris (1994) find that prestigious underwriters avoid the smaller and riskier new issues. Large underwriting firms avoid the smaller firms for three main reasons. First, they are concerned about the reputation of their firm being affected if they begin to participate in the underwriting of the smaller firms. Second the underwriting commission is typically a function of the issue size and thus the larger firms have an incentive to participate in only the larger size issues because of the overhead associated with maintaining their position as a prestigious underwriter. Finally, as Rasch (1994) notes, the low turnover of the small firms makes it unprofitable for the brokerage firms to research the companies because the costs associated with collecting and processing the company information will not be recovered by brokerage commissions.

Thus, a key aspect of the success of a junior market program is being able to attract high quality underwriters. The underwriting firm will be counted upon to perform due diligence on the firms in order to protect their reputation, but will need to earn a sufficient return from their involvement in this marketplace to compensate for their effort and for the risk of inadvertently becoming associated with poorly performing management teams.

3. Overcoming Problems in Junior Equity Markets

3.1. Theoretical Solutions

Private firms that attract venture capital investment have similar characteristics to small public companies: they have significant product market risk, an inexperienced management team, inexperienced directors, less established customer relationships, and stock that is closely held by the firm founders. Thus, it is worthwhile considering whether the governance methods used by the venture capital (VC) industry, which has developed from a very limited source of capital for small growth-oriented firms in the mid-1970s to a multi-billion dollar annual source in

the late-1990s (Gompers and Lerner, 1999), can assist with the governance problems inherent in entrepreneurial public firms.

The VC industry has developed multiple mechanisms in response to the agency problems associated with their investee firms. From an investment portfolio perspective, VCs invest in several firms (Admati and Pfleiderer, 1994) to lower their exposure to any one firm, and will fund in stages (tranches) based on demonstrated firm development (Bergemann and Hege, 1998). Structuring firm investment as a series of stages provides for the resolution of uncertainty about managerial capability and commitment, and motivates managers to focus on increasing firm value over time by posing the threat of otherwise diluting their ownership interest significantly (Gompers and Lerner, 1999).

Looking at each individual portfolio investment, a VC will use contracting to place strong control mechanisms on the actions of firm managers (Triantis, 2001). Each VC deal involves a detailed negotiation between the VC investor and the investee firm that typically includes share and option escrow provisions to prevent shirking or early exiting from the firm by managers (Gompers and Lerner, 1999). Furthermore, VC firms make significant use of unanimous shareholder agreements (USAs) to control management behaviour (Scarvone, 1997). USA agreements allow outside shareholders to have veto power over certain firm decisions usually reserved for the board of directors, e.g. setting executive compensation, approval of major capital expenditures, and approval of the business plan.

Thus, it is possible that imposing VC-like control measures on a small public firm may help mitigate some of the agency problems and lead to enhanced firm performance, and provide better protection for shareholders. In fact, several authors have argued that the directors of entrepreneurial firms should act more like venture capitalists (Porter, 1992; Bhide, 1994). In the absence of a large motivated VC investor to establish these controls through a direct negotiation with the firm founders, and in the absence of a strong independent board of directors, it is possible that standardized regulatory provisions applied to all entrepreneurial public firms could serve to align the interests of firm managers with shareholders.

3.2. US Regulatory Responses to Junior Equity Market Fraud

Although penny stock fraud was an identified problem in the mid-1980s in the US,

regulatory changes did not take place until the US Securities Exchange Commission (SEC) passed the Securities Enforcement Remedies and Penny Stock Reform Act on July 20, 1990. Castelli (2009) noted that the intent of the legislation was not to ban blank check offerings, but to allow investors the opportunity to make more prudent investment decisions and improve their ability to monitor their investments. In reviewing the changes, however, Lampe (1991) argued that the solution derived for the penny stock fraud problem was too expensive and would serve to limit the ability for legitimate firms to access development capital. The outcome of the passage of this legislation was that the number of US blank check offerings decreased significantly in the early 1990s and they largely disappeared from the market during the late 1990s. As Heyman (2007) notes, there were 2,700 US blank check offerings between 1987 and 1990, but less than 15 in the early 1990s.

3.3. Canadian Regulatory Responses to Junior Equity Market Fraud

Unlike the US experience, the Canadian regulatory responses to fraud in the penny stock market were made very quickly. In Canada, securities regulation falls under a province's jurisdiction and thus regulations can vary by province.² There were limited regulations for blind pool equity offerings in the province of Alberta when a small firm in the fall of 1985 proposed raising capital using this approach. As this was a new and controversial method of financing in Canada, the Alberta Securities Commission (ASC) held a hearing in November 1985 before allowing the firm's prospectus to be listed. The firm proposed raising \$50,000 of equity capital by selling shares to a group of insiders, and to the investing public, at a price of \$0.05 each. The money would be used to finance the listing of the firm on the Alberta Stock Exchange (ASE) and the investigation of participation in oil and gas ventures. The ASC approved the prospectus and, as both the inside and outside investors were paying the same amount per share, the ASC ruled that there was no need to hold any portion of the inside investors' shares in escrow.

This firm was listed on the Alberta Stock Exchange (ASE) on April 18, 1986, and over the next few months seven of these offerings were underwritten by the same underwriter. As discussed earlier, the blind pool experiment got off to a rocky start when the second firm listed had its share

² Provincial regulators belong to a national policy group that seeks to harmonize regulations and has developed National Policies (adopted by all jurisdictions) and Multilateral Instruments (adopted by several jurisdictions).

price fraudulently increased from \$0.05 to \$8.00 soon after listing. As a result of this problem, the Alberta Securities Commission (ASC) placed a moratorium on new blind pool stock offerings in October 1986 until the program could be reviewed.

In November 1986, after public hearings, the moratorium on blind pools was lifted, and a new set of regulations were imposed. To overcome the negative publicity and connotation of the name, blind pool, the program in Alberta was renamed the Capital Pool Company program³. The stated objective of the Capital Pool Company program was as follows:

"The Capital Pool Company concept is designed to provide junior start up companies with an enhanced opportunity to become listed on The Alberta Stock Exchange thereby providing a viable and efficient mechanism to enable junior companies to raise further equity capital from the investing public. The Exchange recognizes however that as the listing and prospectus disclosure requirements for Capital Pool Company Companies are substantially less than what is required for other companies, additional requirements are necessary to provide the market with sufficient disclosure and to limit abuse of this system."⁴

The CPC program entailed a firm raising capital in two stages. During the first stage, a group of founders, management and directors, pooled their capital (called seed capital) and then raised money from the investing public (IPO capital) to create a shell company. This shell company then had 18 months within which to complete the second stage, a major asset acquisition termed a Qualifying Transaction (QT), which would transform the CPC into a regularly listed ASE firm. Essentially, the program provided cash for underwriting expenses and some administrative and due diligence expenses, and an 18-month window, within which the CPC founders needed to find a suitable company to bring into the public equity marketplace.

Each CPC had to operate as a true blind pool, and could not have signed any contracts before becoming listed. It was possible, however, for a firm to have entered into letters of intent prior to listing and thus some CPCs were used by firms as an alternative method of going public. It is clear that such a program could be subject to large agency problems if appropriate

³ The original Alberta program was called the Junior Capital Pool (JCP) program, but the name was changed to the Capital Pool Company (CPC) program in November 1999 when the Canadian Venture Exchange (CDNX) was formed through the merger of the Alberta Stock Exchange and the Vancouver Stock Exchange. For purposes of this article, it can be assumed that the JCP and CPC programs are the same.

⁴ See Circular No. 7, The Alberta Stock Exchange, June 1990, p. 7-1.

regulations were not placed upon the firm founders. The ASC and ASE drew heavily from the area of VC control techniques to ensure protection of the outside investors' capital, and to provide the founders with a strong incentive to create value in the firm for all shareholders.

The CPC program adopted VC-like governance mechanisms including escrow provisions for the firm's founders (to remove the incentive for short-term share price manipulation and early founder exit), limits on the use of the firm's capital by the firm founders (to prevent the misuse of corporate resources), providing a veto over the use of proceeds to the outside shareholders (to prevent investment in negative NPV projects), a need for the founders to come back to the capital providers when additional funds are needed, and a requirement to initiate a Qualifying Transaction within a predefined time period (to prevent shirking). Finally, the ASC and ASE created additional regulations to provide protection for investors – some based on the VC diversification model – and to enhance secondary market liquidity. It was not a requirement of the regulations, but many underwriters provided secondary market support to a new CPC issue to enhance its trading liquidity for a short period following its IPO.

3.4. Propositions

It was noted earlier that the US regulatory response to fraud in the penny stock market effectively closed down that market. If the Canadian response was able to strike a more appropriate balance between investor protection and the cost of going public, we would expect that the reaction in Canada would be different. Specifically, we would expect there to be empirical support for the following proposition:

Proposition 1: CPC Regulations Did Not Result in the Effective Closing of this Junior Market

It was earlier noted that the Canadian blind pools created before the adoption of the CPC regulations were adopted had a 61.90% failure rate. If the program was successful in attracting higher quality firms, and limited the involvement of fraudsters in the market, then we would expect to find a lower failure rate for CPC firms versus blind pool firms. Thus, we would expect that the data would support:

Proposition 2: CPC Regulations Increased the Probability of a Blind Pool Becoming a Regularly Listed Firm

To be able to term the overall CPC program a success, we would expect that it would be accepted in other jurisdictions within Canada. For over 10 years no other securities regulators in Canada adopted similar regulations until 1998 when the British Columbia Securities Commission adopted similar regulations to allow the listing of blind pools called Venture Capital Pools (VCPs) on the Vancouver Stock Exchange (VSE). In 1999, the Winnipeg Stock Exchange (WSE) in Manitoba began a similar program called the Keystone program.⁵ The CPC program remained intact following the merger of the ASE and the VSE to form the Canadian Venture Exchange (CDNX) in November 1999, and following the acquisition of the CDNX by the Toronto Stock Exchange in August 2001; however, the CPC program was still only available to investors in Western Canada. In 2002, the regulators in the provinces of Ontario and Quebec agreed to allow the program to operate in their provinces. If this program is seen as benefiting firms in these other jurisdictions, we should find evidence consistent with:

Proposition 3: CPC Regulations Attracted Firms from Outside Alberta over Time

As noted above, a key problem with junior equity markets is the fact that they are subject to a relatively high level of fraud. Prior to the adoption of the CPC regulations, almost 20% of blind pools in Canada were investigated for fraudulent practices which is well above the benchmark noted in more reputable markets. To the extent that the CPC program provided more protection for individual investors, and kept the fraudsters out of this market, we should find empirical support for the following proposition:

Proposition 4: CPC Regulations Decreased the Incidence of Fraudulent Behaviour

As earlier noted, high quality underwriters tend to avoid firms in the junior equity marketplace. If the CPC regulatory changes served to attract higher quality issuers to this market, we would expect that the involvement of high quality underwriters would also increase in this market. Thus, we should observe evidence consistent with the following proposition:

Proposition 5: CPC Regulations Increased the Quality of Underwriting Firms in this Market

⁵ In this study, we examine all Canadian blind pools including the 21 that were listed prior to the adoption of the CPC program and the ones that were listed on the VSE and the WSE. Thus, our results are based on the entire population of all blind pools in Canada.

Given that the CPC regulations have attracted higher quality underwriters to the market, we would expect a similar increase in the quality of the firms using this marketplace to go public over time. This will be evidenced by larger firms using the program and an increase in the survival rate and graduation rate (the rate at which these junior firms graduate to a more senior exchange) over time. Thus, we should observe that:

Proposition 6: CPC Regulations Increased the Overall Quality of Firms in this Market

We note that two earlier studies with respect to the effectiveness of the CPC program reached different conclusions about the program. Robinson (1997) studied the program from 1986 to 1992 and concluded that it represented an effective program for firms raising capital and provided investors with returns similar to those earned by VC investors. In a review of Robinson's work, Kirzner (1997) expressed reservations about whether such a program could exist outside the confines of the province of Alberta. Carpentier and Suret (2006) studied the program over the 1995-2001 time period and showed that the performance of firms subsequent to the QT was lower than the performance of similar firms. However, no study to date has examined the entire 25 year history of the CPC program and documented its impact on the incidence of fraud or success in the junior equity market.

4. Data and Empirical Analysis of the Canadian CPC Program

4.1 Data

IPO data with respect to each blind pool and CPC firm listed in Canada was gathered from two key sources. Information on the 21 blind pools that were listed between in 1986 and on the CPC firms that were listed between 1987 and November 1999 on the Alberta Stock Exchange (ASE) was hand gathered from ASE printed documents. For the IPOs that took place on the Canadian Venture Exchange (CDNX) and the TSX Venture Exchange (TSXV) between November 1999 and December 31, 2010, and for all the VSE's VCP and WSE's Keystone firms, the data was gathered electronically from the Financial Post Infomart database. To identify which blind pools and CPC firms became successful regularly listed companies, we relied upon ASE printed

documents, supplemented by information from the TSXV Infoventure web site. To determine which firms were the subject of a criminal investigation we checked each company against the CanLII database which is maintained by the Federation of Law Societies of Canada and reflects any criminal investigations and/or convictions within Canada. To search for regulatory investigations and/or sanctions, we checked the provincial database for the jurisdiction in which the firm was registered and for the province in which it was listed. As well, we conducted a Factiva search of the overall Canadian blind pool and CPC programs. Finally, to gather information about the reputation ranking of underwriters in this market, we used the league tables from the Financial Post Infomart database, augmented with data purchased from the Financial Post for IPOs prior to 1993.

4.2 Univariate Analysis of CPC Program

To test Proposition 1, data on the number of firms going public and their size in the Canadian blind pool stock market was analyzed. As seen in Table 1, prior to the development of the CPC program, the 21 blind pools that were listed in Canada in 1986 had average seed capital of \$35,833 and average IPO capital of \$67,462 for an overall post-IPO capital based of just over \$100,000. Upon its adoption in late-1986, the CPC program was very successful in increasing both the number and size of junior firms that were publicly listed in Alberta in 1987 and 1988; however, the use of the program diminished significantly in 1989 and during the Canadian economic slowdown of the early 1990s. Beginning in 1993 there was a steady rise in the number and size of CPCs going public until the bursting of the Internet bubble in 2001, which negatively affected the ability of all firms to go public. After recovering from this event, the program had a significant increase in listings from 2004 until the worldwide economic slowdown beginning in late 2008. It is interesting to note that although regulations increased the maximum post-IPO capitalization (the combination of seed and IPO capital) from \$0.5 million to \$0.7 million in 1999, to \$2.0 million in 2003, and to \$5.0 million in 2011, the average post-IPO capitalization peaked at just under \$1.1 million in 2004 before declining to between \$0.5 and \$0.6 million in recent years. This reinforces comments from industry participants that the most important benefit of the CPC program is the public listing that it provides, and not necessarily the amount of capital initially raised. Overall, the Table 1 results provide strong support for Proposition 1. Rather than shutting down the blind pool

market as was the case with the US regulations, the CPC regulations created a program that has resulted in 2,182 new listings on Canada's junior equity exchange since 1987, representing \$326.8 million in seed capital and \$727.7 million in IPO capital.

To further illustrate the importance of the CPC program, we note that between 1995 and 2009 a total of 2,210 firms went public on the TSXV of which 1,525 (69.0%) were CPCs. By way of comparison, Vismara et. al. (2012) report that the number of IPOs on the junior European exchanges over this time period was much smaller; 725 in France, 461 in Germany, 82 in Italy and 1,642 in the U.K.

To test Proposition 2, we examine the success of blind pool firms in Canada after the adoption of the CPC regulations. We define one measure of success for blind pools as the ability to become a regularly listed firm. Prior to the adoption of the CPC program, only 81.0% of the firms completed this step and it took an average of 2.66 years. With the adoption of CPC regulations, the transition process became much more onerous and required the completion of a Qualifying Transaction (QT), which required gaining the approval of the stock exchange and the outside investors by providing prospectus level disclosure of the proposed business transaction. Table 2 shows for each year of the program the percentage of firms that completed a QT, and the average completion time. The success rate increased following the adoption of the CPC regulations, and the time to complete the QT decreased. For most years, the success rate exceeded 90% and the average time to complete a QT was less than 18 months, although for CPCs that started just prior to periods of economic slowdown (1989, 2000, and 2007) the success rate declined and the average time to complete a QT lengthened. These results provide support for Proposition 2 that the development of the CPC regulations increased the quality of junior firms being taken public.

To test Proposition 3, the geographical dispersion of firms going public using the CPC program was determined (see Table 3). For summary purposes, the rows in Table 3 were set to correspond to key regulatory changes in the life of the CPC program. The table shows that the percentage of firms from the province of Alberta was very high when the program was restricted to Alberta investors only (Blind Pool Only and ASE JCP Only), but the importance of Alberta-based firms has been steadily declining over time. The competing programs (VCP and Keystone) were successful in attracting new listings from firms outside Alberta, and from March 2000 onward the largest number of firms has come from the province of British Columbia. We also note that Ontario

and Quebec have become a much more important source of CPC firms since the program was expanded to include investors from those provinces. These results provide strong support for Proposition 3 that the CPC program has evolved over time from one predominately based in Alberta to a program primarily used by issuers from outside that province.

There were a large number of frauds documented with respect to US blind pools in the 1980s. To test Proposition 4, information about each of the Canadian blind pools and CPC firms issued between 1986 and 2010 was examined to determine if fraud was also a problem in the Canadian market. Fraud could manifest itself in a number of different manners, including disseminating false financial or other information to mislead investors, engaging in manipulative stock trading behaviour, or misusing corporate funds. The first two types of problems would likely lead to criminal charges, as well as to regulatory sanctions, while the latter might only lead to regulatory sanctions. To determine which blind pools were the subject of a criminal investigation we checked each blind pool against the CanLII database which is maintained by the Federation of Law Societies of Canada and reflects any criminal investigations and/or convictions within Canada. To search for regulatory investigations and/or sanctions, we checked the provincial database for the jurisdiction in which the blind pool was registered and for the province in which it was listed. Finally, we also conducted a Factiva search of the overall Canadian blind pool program. We restricted our analysis to the first five years following the listing of a firm as this is the critical period in the development of a blind pool and the results of this examination are outlined in Table 4.

Each row in Table 4 represents the percentage of the total blind pools within a given time period that were investigated and/or found guilty of fraudulent behaviour. There are six columns of data in this table, capturing whether criminal charges were brought against a blind pool or its founders or underwriters, whether a conviction was obtained on those charges, whether a blind pool or its founders or underwriters were the subject of any regulatory hearings, and whether those hearings resulted in any sanction. Finally, the last two columns provide a total for both criminal or regulatory charges (adjusted for double counting) and a total for criminal convictions or regulatory sanctions being imposed.

The first two rows reflect the period in which blind pools were allowed in Canada but before the CPC regulations were developed. The first row shows the outcome for the first seven blind pools that were listed by the regional investment dealer that was soon thereafter closed down. One

of the first seven blind pools was the subject of a criminal investigation and conviction for fraud, and one additional pool was the subject of a regulatory hearing. Thus almost 30% of the first seven pools were investigated for misdeeds, and one of seven was found guilty. The second row represents the experience of all 21 of the firms that were listed as blind pools in 1986, and shows that almost one in five were investigated and charges or sanctions imposed on almost one in ten. These values serve as one base case against which the results following the development of the CPC regulations can be prepared. Additional base cases can be developed by reviewing studies of fraud in other markets. The incidence of fraud noted in the US, Canadian and UK markets by Cumming and Johan (2012) was much lower than the above Canadian blind pool values. As previously discussed, they reported average annual fraud ranging from 0.10% for junior Canadian and UK firms to 4.41% for US NASDAQ firms. If the CPC program has been successful in overcoming fraud in the Canadian penny stock market, we would expect to see overall fraud values closer to those found by Cumming and Johan (2012) as opposed to what was observed in the Alberta blind pool market in 1986.

The final four rows in Table 4 correspond to key periods in the CPC program. The first of these four rows represents the period when the program was restricted to Alberta only while the second of the four rows represents a competing period when similar programs were adopted in BC and Manitoba. The third of the four rows include the period when the Alberta and Vancouver stock exchanges merged, and the final row corresponds to the period when the program was extended to Canada's largest capital market in Ontario. In all cases, we can see that the incidence of fraud investigation and the incidence of fraud findings decreased significantly once the CPC regulations were introduced. From a benchmark investigation rate of 19.05% over 8 months for blind pools, the average annual rate (of criminal or regulatory charges) was reduced to 0.21% per year when the CPC program was restricted to Alberta residents only and no fraud was observed for the 50 VCP and Keystone firms; however, fraud increased slightly to 0.37% per year when the Alberta and Vancouver exchanges merged. Finally, the fraud level fell to 0.13% per year when expanded to Ontario and other provinces. This later result is in line with the Cumming and Johan (2012) results for Canada's junior equity marketplace. Overall, these results highlight that the imposition of the CPC program restrictions helped to overcome fraud in Canada's junior equity marketplace by attracting higher quality entrepreneurs and restricting the ability of fraudsters to gain control of a

blind pool firm.

One other issue with respect to the CPC regulations was whether they were able to increase the willingness of higher quality underwriters to bring blind pools to the market. A key result of the US experience with blind pools was that the program was supported by lower tier underwriting firms which would have a lower level of reputation than the top tier underwriters. As discussed above, the first seven blind pools in Alberta were brought to market by a small, young, regional underwriter that was ranked 55 out of the 72 firms on the league table for that year, where a higher rank on the league table corresponds with a higher reputation. During the remainder of 1986, the blind pool underwriters were also relatively low on the league table (i.e. lower reputation) with an overall average league table ranking of 40 and with only one blind pool supported by an underwriter in the top 20 in Canada. As illustrated in Figure 1, following the adoption of the CPC regulations, the quality of underwriting firms increased significantly with an average underwriter ranking of 27 in 1987 and 21 in 1988. This figure also illustrates that the average underwriter ranking has varied over the past 25 years, and appears to drop during years when a large number of CPCs are brought to the market. While the average underwriter league table ranking appears to be increasing in recent years, this may be due to an increase in the overall number of underwriters within the Canadian marketplace. Thus, a more useful indicator of the ability of the CPC program to attract high quality underwriters would be to examine the percentage of CPC financings involving underwriters in the top 20 and top 10 (as found in Figure 2). This figure indicates that since the CPC program was expanded to other provinces in late 1999, that the percentage of financings involving underwriters in the top 20 on the league tables has been roughly 50%, and the percentage of underwritings involving the top 10 underwriters on the league table has steadily increased to around 30%.

As seen in Table 5, the cash compensation to underwriters from these IPOs has been increasing over time, but at an average of approximately \$50,000 in recent years, is still relatively low.⁶ Where the underwriters plan to make their major gains is in the options they are granted, which averaged just under 10% in recent years, and in the ability to help the firm with future financings. Looking at all these results, we can conclude that there is strong evidence that the CPC

⁶ The CPC regulations set the maximum cash compensation to agents at 10% of the IPO proceeds and the maximum amount of options at 10% of the number of IPO shares. Options have an exercise price equal to the IPO price and in 2011 had a 24 month expiry period.

market has increased its reputation among underwriters over time and thus the participation of higher quality underwriters in the CPC marketplace has increased over time, consistent with Proposition 5.

To examine whether the CPC regulations helped increase the quality of firms using the CPC program, we note that Table 1 shows a significant increase in the average seed and IPO proceeds from the early to the later years of the CPC program. In addition, Table 6 illustrates that prior to the adoption of the CPC program in Canada, the success rate of Canadian blind pools (defined as the firm staying listed on the exchange for at least 5 years after it completed its QT, or if it was delisted that the reason for the delisting was due to the firm either completing an amalgamation, being taken over, or graduating to a more senior exchange) was 38.1%; however, the success rate was significantly higher in all years following the adoption of the CPC regulations. In addition, the graduation rate for blind pools that went public in 1986 was less than 5.0%, but once the CPC program was adopted the graduation rate rose significantly.⁷ These results support Proposition 6 that the quality of firms going public using a blind pool method increased after the adoption of the CPC regulations.

4.3 Multivariate Analysis of CPC Program

To confirm the above univariate results, we also conducted a multivariate analysis of the factors that affected three measures of the CPC program represented by dummy variables: *Fraud* is a set to one if the firm was investigated for, or found guilty of fraud, in either administrative or criminal proceedings, and set to zero otherwise; *Success* is set to one if the firm stayed listed on the exchange for at least 5 years after it completed its QT, or if it was delisted due to the firm either completing an amalgamation, being taken over, or graduating to a more senior exchange, and set to zero otherwise; and *Graduate* is set to one if the firm ever moves to a more senior exchange, such as the TSX, and set to zero otherwise.

Our explanatory variable is *CPC_Regulations* a dummy variable set equal to one for all blind pools completed after the regulations came into effect, and zero for the 21 blind pools completed before the adoption of the regulations. Control variables include the percentage of the

⁷ Our data shows that the minimum time for a firm to graduate after the QT was 0.0 years, while the maximum time was 22.8 years. On average, of those firms that graduated, it took them an average of 5.4 years following the QT.

firm owned by the founders post-IPO (a measure of managerial alignment), the size of the firm post-IPO, a set of industry dummy variables, and *Top 10 Underwriter* a dummy variable set to one if the underwriter was in the top 10 of the league list for the issuing year, and set to zero otherwise (a measure of underwriter reputation).

We completed a binary logistic regression and our regression results are presented in Table 7. Looking at the determinates of *Fraud*, we can see that the CPC regulations had a significant impact on reducing the incidence of fraud in the junior equity market and that there was significantly less fraud associated with the larger offerings. With respect to *Success*, we note that there is weak evidence of a positive impact associated with the adoption of the CPC regulations, but there was a stronger positive relationship between firm success and the percentage of the firm held by the seed investors after the IPO, the size of the offering, the industry, and the involvement of a top 10 underwriting firm. When examining the ability of a firm to grow and *Graduate* the coefficient on CPC regulations was large in absolute value, but not statistically significant, and again there was a strong positive relationship between a firm's ability to graduate and the percentage of the firm held by the seed investors after the IPO, the industry, and the involvement of a top 10 underwriting firm. To the extent that the CPC regulations have helped attract more reputable underwriting firms to this market, we can ascribe some of the higher success and graduation rates to the regulations.

5. Summary and Conclusions

Blind pools in Canada began to be listed in 1986, and in the absence of effective regulation proved to be susceptible to fraud by the firm's principals and their underwriters. In response to these problems, the Alberta Securities Commissions and the Alberta Stock Exchange developed a series of regulatory requirements that attempted to provide sufficient protection to investors without placing an undue burden on reputable junior firms attempting to raise equity. The program has experienced steady growth over the past 25 years, both in terms of the number of firms that have raised capital using the program and in the jurisdictions which have adopted the regulations, and as at December 31, 2010, 2,182 CPC firms have been listed with IPO proceeds totalling \$727.7 million.

Unlike US estimates that only a small fraction of such blind pools will turn into real

ventures, the overall Canadian experience is that over 90% of these firms have been able to complete their QT and in some years all firms were successful in passing over this hurdle. In addition, the program has broadened geographically. For the first almost fifteen years of the program only investors in the province of Alberta were able to participate in the IPOs of CPC firms, but since 2002 investors in all the major provinces of Canada can invest in such securities.

Our empirical analysis shows that the CPC program has been able to assist developing firms raise an increasing amount of capital over time, and has been able to attract high quality entrepreneurs, and underwriters, which has resulted in higher success for the listed firms and avoided many of the problems of fraud found in many other junior equity programs.

The program has been successful for two key reasons. First, the regulators placed VC-like governance mechanisms on firm founders that required them to create value for the outside shareholders before they were allowed to trade their shares. In addition, the firm founders were constrained in their ability to access the IPO proceeds, and outside investors and the TSX Venture Exchange were required to be provided with prospectus level disclosure and approve any QT proposed by the firm's founders.

Second, the regulators have required that the underwriters who take these CPC firms public must ensure that the investment is appropriate for their clients' investment needs and objectives. Rather than there developing a second tier of underwriting firms for these types of offerings, the evidence shows that the program has been adopted by leading Canadian investment dealers who will be very concerned with their reputation when determining whether to accept one of these CPC firms as a client. In addition, the success of the program has meant that the underwriters are prepared to derive a large part of their compensation from the options they are granted by the issuers.

Overall, we feel that the success of the TSXV's CPC program has demonstrated that it is possible to develop an effective regulatory regime with respect to the listing of blind pool firms that will provide protection for investors without limiting the ability of firms to raise capital. Specifically, we have shown that the adoption of the CPC regulations significantly lowered the risk of fraud in the blind pool market in Canada, and helped attract higher quality firms and underwriters to this market. Starting from a program available to investors in only one province of Canada, over the past 25 years the program has been approved by most securities regulators in Canada

representing the vast majority of Canadian investors. Perhaps more importantly, the program has been adopted in jurisdictions that are based on civil law (Quebec) as well as British common law (all other provinces). Thus, we believe that the results in Canada could be achieved in other jurisdictions that are based on either legal system.

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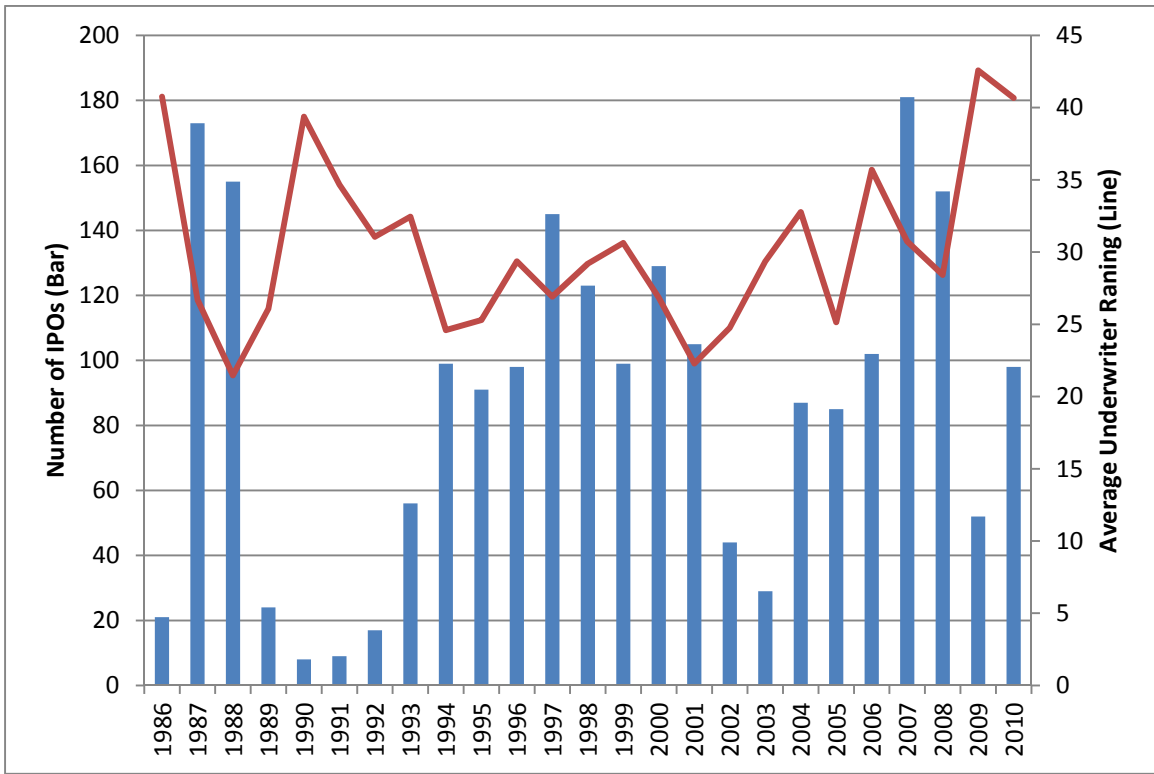


Figure 1: Yearly average underwriter raking and number of IPOs

This figure presents the average IPO ranking of CPC underwriters by year. The dashed line represents the number of IPOs, where the ranking is shown on the right axis. The bars represent the number of IPOs with the absolute number of IPOs shown on the left axis. The year 1986 was the period prior to the adoption of the CPC program regulations.

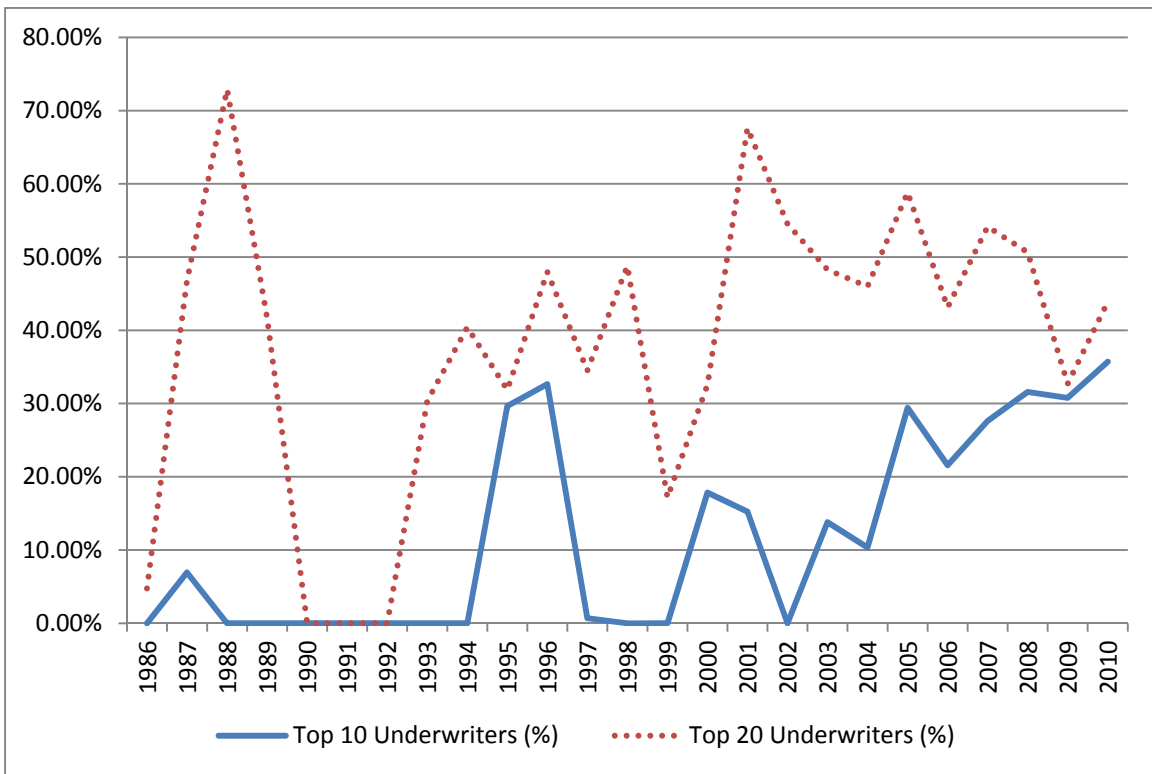


Figure 2: Yearly Percentage of CPC IPOs segmented by underwriter rank

This figure presents the percentage of CPC IPOs that were underwritten by a broker in the top 10 of the league tables and in the top 20 of the league tables per year. The year 1986 was the period prior to the adoption of the CPC program regulations.

Table 1: Yearly number of blind pools and capital raised

This table reports the yearly number of blind pools (1986) and CPC firms (all other) and capital raised at the seed stage and the IPO stage of the CPC process. *Total seed (\$)* is the total dollar amount invested by the CPC founders. *Mean seed (\$)* is the average dollar amount invested by the CPC founders. *Total IPO (\$)* is the total dollar amount invested by the IPO investors. *Mean IPO (\$)* is the average dollar amount invested by the IPO investors. The year 1986 was when blind pools were listed prior to the adoption of the CPC program. The total CPC row thus includes the period 1987 to 2010 only.

Year	N	Total Seed (\$)	Mean Seed (\$)	Total IPO (\$)	Mean IPO (\$)
1986	21	752,500	35,833	1,416,700	67,462
1987	173	6,620,939	38,271	15,836,900	91,543
1988	155	6,251,105	40,330	18,413,000	118,794
1989	24	1,027,322	42,805	3,317,900	138,246
1990	8	456,500	57,063	1,245,000	155,625
1991	9	460,795	51,199	1,380,000	153,333
1992	17	991,750	58,338	2,820,000	165,882
1993	56	3,630,583	64,832	11,000,000	196,429
1994	99	10,237,859	103,413	23,788,975	240,293
1995	91	10,262,894	112,779	22,482,500	247,060
1996	98	13,533,447	138,096	24,485,000	249,847
1997	145	24,067,775	165,985	36,555,000	252,103
1998	123	21,085,230	171,425	30,627,500	249,004
1999	99	16,611,135	167,789	28,100,500	283,843
2000	129	10,570,340	151,708	39,677,400	307,577
2001	105	18,252,146	173,830	36,213,049	344,886
2002	44	8,701,502	197,761	16,794,408	381,691
2003	29	5,108,982	176,172	17,531,535	604,536
2004	87	18,964,583	217,984	76,089,203	874,589
2005	85	18,007,570	211,854	56,812,106	668,378
2006	102	23,533,080	230,716	55,827,296	547,326
2007	181	37,768,434	208,655	84,861,850	468,850
2008	152	30,950,045	203,619	60,382,309	397,252
2009	52	10,588,253	203,620	19,233,001	369,865
2010	98	19,386,095	197,817	42,831,364	437,055
Total CPC	2,182	326,820,864	149,780	727,722,495	333,512

Table 2: Percentage of firms that successfully completed a QT and time to completion

The year 1986 was when blind pools were listed prior to the adoption of the CPC program when there were limited requirements for a blind pool to become a regularly listed firm. Beginning in 1987, when the CPC program regulations were adopted the values represent the percentage of the firms that were able to complete their Qualifying Transaction (QT) and turn into a regularly listed firm and the average time that the successful firms took to complete their QT. The values in 2009 and 2010 cannot be directly compared against earlier years since many CPCs during those years are still within the 2 year window to complete a QT; however, to make them more comparable all firms that are still listed as a CPC are excluded from the analysis.

Year	Complete QT (%)	Mean years to complete QT
1986	80.95	2.66
1987	95.95	1.37
1988	89.68	1.48
1989	87.50	1.44
1990	100.00	1.95
1991	88.89	1.43
1992	100.00	1.07
1993	92.86	0.91
1994	89.90	1.17
1995	95.60	1.26
1996	92.86	1.20
1997	91.03	1.28
1998	96.75	1.24
1999	90.91	1.70
2000	90.70	2.11
2001	94.29	1.75
2002	90.91	1.57
2003	93.10	1.38
2004	98.85	1.25
2005	92.68	1.42
2006	95.10	1.46
2007	92.90	1.89
2008	96.30	1.83
2009	95.65	1.68
2010	100.00	1.05

Table 3: Percentage of issuing firms segmented by jurisdiction during different regulatory environments

This table reports the percentage of the blind pool financings from a given jurisdiction over a given period. *Blind Pool Only* includes the 21 blind pools that were listed in Canada before the development of the CPC program *ASE JCP Only* represents the period of time when the JCP program was only available to Alberta investors. *VCP/Keystone Only* includes the period when competing blind pool programs were initiated in British Columbia and Manitoba.⁸ *CDNX/TSXV CPC* includes the period when the ASE and VSE merged and the program was expanded to include some other provinces in Canada. *TSXV CPC* is the period of time over which the program has been made available to investors in Canada's largest province, Ontario.

	Calendar Period	Jurisdiction of Issuer					
		Alberta (%)	B.C. (%)	Ontario (%)	Quebec (%)	Rest of Canada (%)	Outside Canada (%)
Blind Pool Only	04/18/1986–12/30/1986	95.24	0.00	4.76	0.00	0.00	0.00
ASE JCP Only	12/31/1986–02/29/2000	72.51	13.79	8.26	2.91	2.16	0.38
VCP/Keystone Only	8/27/1998-3/26/2001	2.00	82.00	2.00	0.00	12.00	2.00
CDNX/TSXV CPC	03/01/2000–06/14/2002	34.02	36.93	13.28	10.37	3.73	1.66
TSXV CPC	06/15/2002–12/31/2010	19.40	39.93	24.13	10.57	3.73	2.24

⁸ This time period overlaps with the ASE JCP Only period as the competing programs started while the JCP program was still in existence. It also overlaps with the CDNX/TSXV CPC period as the WSE did not merger with the CDNX until November 2000 and the last Keystone firm started under that program was not taken public until March 26, 2001.

Table 4: Percentage of blind pools for which there was an investigation or finding of fraudulent practices

This table reports the percentage of blind pools, or their principals or underwriters, which were the subject of a criminal investigation, criminal conviction, regulatory hearing or regulatory sanction, over a given period. *First Commonwealth* and *Blind Pool Only* refer to periods when there were limited regulations on Canadian blind pools. More specifically, *First Commonwealth* represents the period over which the first seven blind pools were brought to market by the underwriter, First Commonwealth Securities, which was forced to cease operations soon thereafter. *Blind Pool Only* includes all 21 blind pools that were listed in Canada before the development of the CPC program. *ASE JCP Only* represents the period of time when the JCP program was only available to Alberta investors. *VCP/Keystone Only* includes the period when competing blind pool programs were initiated in British Columbia and Manitoba.⁹ *CDNX/TSXV CPC* includes the period when the ASE and VSE merged and the program was expanded to include some other provinces in Canada. *TSXV CPC* is the period of time over which the program has been made available to investors in Canada's largest province, Ontario. This later time period is restricted to the end of 2005 to allow there to be an examination of five years of trading subsequent to the IPO.

	Calendar Period	Criminal Charges (%)	Criminal Conviction (%)	Regulator Hearing (%)	Regulator Sanctions (%)	Criminal or Regulator Charges (%)	Conviction or Sanctions (%)
First Commonwealth	04/18/1986 – 07/10/1986	14.29	14.29	14.29	0.00	28.57	14.29
Blind Pool Only	04/18/1986 – 12/30/1986	9.52	4.76	14.29	4.76	19.05	9.52
ASE JCP Only	12/31/1986 – 02/29/2000	0.38	0.09	2.72	1.78	2.81	1.88
VCP/Keystone Only	8/27/1998-3/26/2001	0.00	0.00	0.00	0.00	0.00	0.00
CDNX/TSXV CPC	03/01/2000 – 06/14/2002	0.00	0.00	0.83	0.00	0.83	0.00
TSXV CPC	06/15/2002 – 12/31/2005	0.12	0.00	1.12	0.62	1.24	0.62

⁹ This time period overlaps with the ASE JCP Only period as the competing programs started while the JCP program was still in existence. It also overlaps with the CDNX/TSXV CPC period as the WSE did not merger with the CDNX until November 2000 and the last Keystone firm started under that program was not taken public until March 26, 2001.

Table 5: Summary of agent compensation during different regulatory environments

This table reports the average seed capital, the average IPO capital, the average cash commission paid to underwriters, and the average percentage of options (as a percentage of the IPO shares) issued to underwriters, over a given period. *Blind Pool Only* includes the 21 blind pools that were listed in Canada before the development of the CPC program. *ASE JCP Only* represents the period of time when the CPC program was only available to Alberta investors. *VCP/Keystone Only* includes the period when competing blind pool programs were initiated in British Columbia and Manitoba.¹⁰ *CDNX/TSXV CPC* includes the period when the ASE and VSE merged and the program was expanded to include some other provinces in Canada. *TSXV CPC* is the period of time over which the program has been made available to investors in Canada's largest province, Ontario.

	Calendar Period	Mean Seed Capital (\$)	Mean IPO Capital (\$)	Mean agent cash commission (%)	Mean Agent Options (%)
Blind Pool Only	04/18/1986 – 12/30/1986	35,833	67,462	1.19	6.19
ASE JCP Only	12/31/1986 – 02/29/2000	103,089	196,281	7.53	10.00
VCP/Keystone Only	8/27/1998-3/26/2001	154,970	322,810	9.88	9.44
CDNX/TSXV CPC	03/01/2000 – 06/14/2002	165,820	334,132	9.85	9.78
TSXV CPC	06/15/2002 – 12/31/2010	209,533	522,890	9.69	9.64

¹⁰ This time period overlaps with the ASE JCP Only period as the competing programs started while the JCP program was still in existence. It also overlaps with the CDNX/TSXV CPC period as the WSE did not merger with the CDNX until November 2000 and the last Keystone firm started under that program was not taken public until March 26, 2001.

Table 6: Percentage of firms that were deemed a success and which graduated to a senior exchange

We define success as a firm that remains listed for at least five years following its QT, or which was delisted during that period due to an amalgamation, a takeover, or a graduation to a more senior exchange. Graduation to a more senior exchange, the third column, could have taken place more than five years after a QT. The year 1986 was when blind pools were listed prior to the adoption of the CPC program. Beginning in 1987, when the CPC program began the values represent the percentage of the firms that were able to complete their QT and turn into a regularly listed firm and the average time that the successful firms took to complete their QT. The years 2004 to 2010 are not included in this table, as there may not have been five years elapsed from the time of the firms QT and the end of 2010 (as a firm has up to 2 years to complete the QT).

Year	Success (%)	Graduation (%)
1986	38.10	4.76
1987	67.05	25.43
1988	61.94	13.55
1989	70.83	8.33
1990	100.00	25.00
1991	44.44	0.00
1992	64.71	23.53
1993	83.93	21.43
1994	77.78	27.27
1995	79.12	21.98
1996	71.43	19.39
1997	77.24	16.55
1998	71.54	19.51
1999	66.67	13.13
2000	75.19	14.73
2001	80.95	12.38
2002	72.73	20.45
2003	72.41	3.45

Table 7: Binary logistic regression of the factors influencing Fraud, Success, and Graduate dummy variables

This table shows the factors that affect three measures of the CPC program measured by dummy variables: *Fraud* is a set to one if the firm was investigated for, or found guilty of fraud, in either administrative or criminal proceedings, and set to zero otherwise; *Success* is set to one if the firm stayed listed on the exchange for at least 5 years after it completed its QT, or if it was delisted due to the firm either completing an amalgamation, being taken over, or graduating to a more senior exchange, and set to zero otherwise; and *Graduate* is set to one if the firm ever moves to a more senior exchange, such as the TSX, and set to zero otherwise. Our explanatory variable is *CPC_Regulations* a dummy variable set equal to one for all blind pools completed after the regulations came into effect, and zero for the 21 blind pools completed before the adoption of the regulations. Control variables include the percentage of the firm owned by the founders post-IPO (*Percentage_Seed*), the size of the firm post-IPO ($\ln(\text{Seed} + \text{IPO Proceeds})$), a set of industry dummy variables, and *Top 10 Underwriter* a dummy variable set to one if the underwriter was in the top 10 of the league list for the issuing year, and set to zero otherwise (a measure of underwriter reputation).

	Fraud	Success	Graduate
CPC_Regulations (Dummy)	-1.525**	0.854*	1.470
Percentage_Seed	-2.581	1.799***	1.338**
Ln(Seed + IPO Proceeds)	-1.211***	0.459***	-0.135
Resource Firm (Dummy)	0.518	1.265***	0.688***
Technology Firm (Dummy)	0.847	0.418**	0.424*
Real Estate Firm (Dummy)	-16.987	1.563***	0.722**
Financial Firm (Dummy)	-17.112	0.976*	1.267***
Top 10 Underwriter (Dummy)	0.247	0.628**	0.470**
Intercept	2.410*	-2.723***	-3.613***
N	1,385	1,385	1,385
Nagelkerke R-squared	.133	.136	.043

Includes all blind pools that went public from 1986 until 2003.

***, ** or * signify that the test statistic is significant at the 1, 5 or 10% level, respectively.