



During the past 20 years, the number of operating companies listed on the Toronto Stock Exchange has dropped by more than 35 per cent. FRED LUM/THE GLOBE AND MAIL

Canada's stock market is broken and our economy remains vulnerable unless we fix it

STEPHEN PINCUS
BRAD ROSS

OPINION

Stephen Pincus and Brad Ross are partners at law firm Goodmans LLP.

The trade war with the U.S. has drawn Canadians' attention to the need to strengthen our economy and make it less reliant on others. That cannot be done without fixing our broken capital markets.

During the past 20 years, the number of operating companies listed on the Toronto Stock Exchange has dropped by more than 35 per cent. Over that period, the three-year average number of TSX operating company IPOs has dropped from 40 to less than two per year, and the average amount raised on those IPOs has dropped from \$3.5-billion to less than \$1-billion per year. The decline is stunning.

This is a major problem for Canada's businesses and our economy as a whole. It also directly harms Canadian families and retirees. The weakness of Canada's capital markets and resulting reliance on foreign sources of capital threatens the country's economic sovereignty.

The lack of healthy domestic public markets hinders access to capital for Canadian businesses. This makes it more difficult for them to improve productivity and remain competitive. It also forces Canadian businesses to seek capital elsewhere. Large companies may be able to access the U.S. public markets, but this means foreign ownership and regulation by the U.S. government. Smaller and medium-sized companies must rely on private capital – often also from foreign sources – which typically involves limited investment time horizons, significant debt burdens and less transparency than the public markets.

Then things get worse. Private owners need to monetize their investments. If a Canadian IPO is not viable, the typical exit path would be the sale of the Canadian business to a foreign company or private investor. Foreign ownership costs Canada our head offices, our human capital and our intellectual property. The flight of intellectual property discourages its future development, and the knock-on effects of this may be felt for generations.

Most Canadians are not able to directly invest in private equity firms or private companies. Without a broad range of stock-exchange listed Canadian businesses to invest in, Canadian families have limited investment opportu-

nities. This problem especially affects retired Canadians who rely on income-generating investments. The decline of Canada's public capital markets thus increases economic inequalities between the wealthiest Canadians, who can invest privately, and average Canadians, who rely on the public markets.

Provincial securities regulators can help by removing some of the barriers to companies going public and remaining public in Canada. These changes are important, but studies have shown that alone they are unlikely to reverse the downward trend.

We need our federal government to kick-start the reversal by using fiscal and tax policy to encourage businesses to list and stay listed on Canadian stock exchanges, and to incentivize Canadians to invest in them. A range of potential creative solutions – some based on adapting successful precedents – are available for different types of businesses and industries.

Investors in some resource exploration and development companies, for example, can convert potential future losses into current capital where the companies “flow through” those losses to their shareholders. Such “flow through” structures could be adapted to encourage investment in publicly listed technology and other growth-oriented companies. This could ignite fresh capital markets activity in a critical sector of the Canadian economy.

On the other hand, for retirees and other Canadians who need investments that yield steady cash flow, it may be worth adapting a “made in Canada” capital markets product that was highly popular in the early 2000s: the income trust. The vast majority of TSX IPOs in this period used this structure, which not only enabled mature Canadian businesses to access capital and grow but also attracted non-Canadian businesses to list on the TSX. Concerns about potential tax leakage could be addressed by limiting the use of this structure to smaller and medium-sized companies.

Other potential solutions could include reduced corporate tax rates for companies that go public, capital-gains tax relief for share sales after an IPO, accelerated tax deductions for IPO costs, and other tax credits or incentives for investment in small and medium-sized public companies.

So long as our capital markets are unattractive to companies and investors, the Canadian economy will remain vulnerable to attack. If we soon head into a federal election as expected, we should call on all parties to seize this opportunity and propose ways to revitalize our Canadian capital markets. Our economic sovereignty depends on it.