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The survival and success of Canadian penny stock IPOs

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Abstract

We analyze the survival and success of a large sample of Canadian penny stock initial public offerings (IPOs), launched mostly by small and unprofitable firms from 1986 to 2003. The failure rate of these IPOs is lower than in the US for larger IPOs, probably because of lax delisting rules and the market's capacity to refinance non-profitable firms. The survival of new issuers is significantly associated with their characteristics at the IPO and with the level of initial listing requirement they meet. The involvement of reputable intermediaries in the

Notes

1. The definition of a penny stock has been debated for years. In the US, a penny stock IPO is priced under

2000 (Luft and Levine 2004). Accordingly, we consider that penny stocks can be characterized by a market value lower than US$ 10 million.

2. In Canada, firms graduate when they move their listing from the junior exchange (TSXV) to the main exchange, TSX. However, as TSX is itself a junior market relative to the US main exchanges, a firm listed on TSX can graduate to the NYSE.

3. According to our definition in footnote 1.

4. In this field of research, the term "failure" is conventionally defined as the firm's inability to maintain its listing. The delisting is often associated with a bankruptcy, but also with all the situations where the firm is unable to maintain a financial situation that allows it to meet the ongoing listing requirements.

5. The propensity of newly listed firms to fail or succeed is estimated using rates of failure or success in some studies, whereas other researchers measure the time elapsed between the IPO and the event. We use both methods in this study.

listing of a non-operating company; we consequently exclude CPC IPOs from our sample.

8. We compile a list of VCs operating in Canada from 1986 to 2003 from the lists of the Canadian VC Association, the summary of VC lists of Industry Canada (Strategis) and the lists of the equity sources provided by Mike Volker at http://www.sfu.ca/~mvolker/biz/moneylnk.htm.

9. They are: RBC Capital Markets, CIBC World Market Inc., BMO Nesbitt Burns Inc., TD Securities Inc., Scotia Capital Inc., Merrill Lynch Canada Inc. and Goldman, Sachs & Co. No other Canadian-based investment bankers control more than 5% of the total market.

10. NEX is a new and separate board of TSXV that provides a trading forum for listed companies that have fallen below TSXV's ongoing listing requirements.

11. The ongoing listing requirements describe the conditions of price, volume and financial characteristics that any listed firm must meet in order to avoid being delisted. NASDAQ delists a

prices are, on average, one tenth of prices in the US.

13. Graduation and cross-listing are not perfect measures of success for IPOs, because some firms that fulfill the listing requirements of the major exchanges do not move their listing. We consider these firms to have survived, but not to have truly succeeded because they do not attempt to reach a more liquid market to finance their growth at a lower cost of capital. Our indicator is compatible with the proposition that the success of a new market can be assessed by its capacity to enable newly listed firms to raise the capital they need, developed by Bottazzi and Da Rin (2002).

14. These medians can differ slightly from those reported in Table 3, because we are restricted by the availability of accounting data. We were able to collect this information for 2,028 of the 2,373 firms in the population (85.3%).

15. We also test a model with a separation between NORM4 and the other groups, omitting the size variable (not reported). The coefficient associated with NORM4 is negative and highly significant. Issuers that approximate the recent NASDAQ

The model and coefficients estimated using this approach are similar to those reported in Table 6.

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