Corporate Governance: An International Review / Volume 22, Issue 2 / pp. 145-161

Global Perspectives on Entrepreneurship

The Changing Latitude: Labor-Sponsored Venture Capital Corporations in Canada

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First published: 07 March 2014
https://doi.org/10.1111/corg.12057

PDF

Abstract

Manuscript Type

Empirical

Research Question/Issue

This paper seeks to understand the role corporate governance and government policy plays in the portfolio choices of the labor-sponsored venture capital corporations (LSVCCs) in Canada. We investigate whether or not the change in tax policy announced in Ontario (2005) had an impact on the investment behavior of Ontario LSVCCs and whether the unique corporate governance structure of LSVCCs enables them to focus on their investment mandate subsequent to this announcement.

Research Findings/Insights

Our findings suggest that LSVCCs in Ontario are more likely to include public companies in their fund portfolios after the announcement of the change in tax policy. We find that after 2005, LSVCCs have increased their number of investments in public companies by 59.13 percent and in turn decreased their number of investments in private companies by 13.17 percent. On the other hand, we find no significant changes in investment behavior for LSVCCs in other provinces. In terms of the percentage of total investment in public companies, we find that the LSVCCs in Ontario are more likely to increase their total investment in public companies by 50 percent and to decrease provinces. We hypothesize that as a result of the elimination of the tax credits, the removal of certain investment restrictions, and weaker corporate governance, LSVCCs have drifted from their original mandate to invest in high-risk venture companies to investing in less risky public companies. Such style drift may be a result of LSVCCs preparing for potential wealth transfer or liquidation by retail investors. More importantly, we find the unique corporate governance structure of LSVCCs may facilitate this drift from their original purpose of providing venture capital to small and medium-sized entrepreneurial (SME) firms.

Practitioner/Policy Implications

We highlight that the style drift of LSVCCs in Ontario may result in such funds behaving more like other types of mutual funds and the deviation from their original mandate to provide venture capital may not only prove detrimental to entrepreneurial investee firms seeking such capital, but also negate any diversification benefits sought by fund investors. Also, such deviation may not necessarily justify the higher management expense ratio charged by LSVCCs.

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