Forget this TSE obsession and focus on the capital markets

By Roger Martin

At least there has been much talk in the Canadian invest-
ment and finance community about the future of the
Toronto Stock Exchange. The TSE has almost become an obses-
sion with pundits debating the relevance of the Toronto
Global financial environment. Since the TSE is so often equated with the Canadian cap-
ital market, it is not surprising that the fate or
end of the TSE would sound the death
knell of the Canadian capital market,
hobbling our economy.

But the TSE's future is important,
it needn't be an obsession. The
Toronto Stock Exchange does not define the
capital market, it is merely one component. Certainly, the
economic future of Canada depends on
a local capital market, but it is not the
only component. Optimistically, the
economic future of Canada depends on
a local capital market and the presence of
a local stock market in Toronto.

Capital markets consist of a complex
and interacting array of mechanisms and
institutions which mutually create the
conditions in which capital flows effi-
ciently to the highest and best invest-
m ent uses. These mechanisms and
institutions are not solely stock mar-
kets, but also include investment banks;
financial institutions, governments;
and taxation structures.

In aggregate, the quality of these mech-
isms in a country determines whether
a jurisdiction does or does not have a robust capital market — with its
innovating, competitive local banks and
full of financial intermediaries globally.

We tend to look longingly at Califor-
nia's San Francisco Bay Area as the
model for the capital market in the
world. In Silicon Valley, the raising and
borrowing of capital is the most effi-
cient and abundant in the world.

But where is the Bay Area's stock
market? Certainly not in the Bay Area —
not even close. Silicon Valley's stock market,
the New York-based NASDAQ, is on
the other side of the country — far, far,
times closer to Toronto than to Silicon Valley.

Why do we think the Bay Area's capital
market is superior? Because it is the
capital market. Nor does it headquarters the key
players in traditional capital market
institutions. The global investment banks
— Goldman Sachs, Morgan Stanley
Dean Witter, Merrill Lynch and Sal-
mon Smith Barney — are all headquar-
tered in New York. Many of the world's
leading securities law firms: Wachtel
Lipton, Cravath, Swaine & Moore, Sulli-
van & Cullen as well. It's big, it's global.

The truth is: Silicon Valley has grown
an array of mechanisms and institu-
tions that make it the most powerful
financial centre in the world. Not just the
presence or even proximity of an Indige-
nous stock market.

In Silicon Valley, the capital market
epicentre is Sand Hill Road, home of
a whole new breed of venture capital. Firms
such as Kleiner Perkins, Bench-
mark, Sequoia and others have taken the
financing of startups to a level of sophistication not yet seen anywhere
else. They are the venture capital firms
Goodrich & Rosalti rival any New York

law practice as one of the most
important commercial law firms in America. A new class of "angel investors" has tak-
en form, and become a key institution. The law schools and business schools of
UC Berkeley and Stanford attract high-
quality human capital from around the
world, most of whom stay in the area af-
ger graduation. Accounting companies, communictions specialists and con-
sulting firms specializing in issues affec-
ting high-tech firms have come on strewn to support the capital market ac-
tivity. Now, major global investment
banks and law firms are setting up shop
in Silicon Valley, in part to learn how
this special capital market works.

The Bay Area has the most robust cap-
ital market in the world not because it
has an indigenous stock market but be-
cause it built a network of capital market
institutions and mechanisms that serve

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its businesses in a unique and powerful
way. If everyone in the community had
the knowledge that the latest stock
market, or worried that all the impor-
tant investment banks and law firms
were 2,000 miles away on the other side of the world, Silicon Valley wouldn't have devel-
oped such a vibrant capital market.

Here at home, Canadians need to stop
fixating on the TSE. Instead, we need to
ask what capital market institutions and mechanisms we need to
incubate a world-class capital market for
Canadian firms. If we don't have them now, what can be done to
encourage their creation? What role
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I, for one, am cautiously optimistic
that a capital market environment con-
ductive to Canada winning in the new
economy is starting to take shape here. One
indicator is the recent proliferation of
venture capital firms aimed at flow-
ing capital to new economy startups
and supporting them. Entrepreneurs
who just a few years ago had only

traditional financing sources to tap
now have Brightpark, Itrumos, Mosaic
Venture Partners, NRG Group, Watson
Watt, XIV, Putter. And why, they say,
venture capital firms willing and eager
to listen to their innovative ideas.

Our law firms, accounting firms and Invest-
ment banks we have become young sophis-
ticated supporters of this new capital market as well.

We are fortunate that the TSE had the
foresight to fund the University of
Toronto Capital Markets Institute in
1995, a joint initiative of the University
of Toronto's faculty of law and the Joseph
L. Rotman School of Management. The
institute has undertaken, as a central
thrust of its mandate, to answer this
question: What capital market mecha-
nisms and institutions must Canada de-
velop in order to create a world-class
capital market that can support a glob-
ally competitive business sector?

Two or three came to mind immediate-
lly. For example, while we now have a
growing number of venture capital fund-
ing sources, we need them to generate a
level of competition that matches the in-
tensity in Silicon Valley, to ensure that
entrepreneurs have sufficient choice and
bargaining power. And lastly, they're obliged to give up too much in the early
rounds of financing, which leaves too lit-
tle room for investors in later rounds
why the TSE is so close to its capital.

Additionally, we need to develop a more
robust pool of angel investors to provide
the first-stage, speculative early financing. However, these are just isolated exam-
ple. We need a much more comprehen-
sive strategy for supporting the capital
markets to ensure progress in Canada.

Later this year, the Capital Mar-
kets Institute will bring together leading
technology investors and government
officials to address this very matter and identify
the research necessary to answer this
to the next phase of development.

If Canada is to succeed in the new
season, we need to rise above narrow,
parrainel questions surrounding the
TSE and focus instead on the big picture.
The question that counts is: How do we develop a broader capital markets and
create a nurturing environment for en-
gines of economic growth to develop in
centres across the country? This is the
way for Canadian firms to win, not only
in their local markets, but within the
new global economy as well.

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sity of Toronto.