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THE ALTERNATIVE OF PRIVATE REGULATION: The London Stock Exchange's Alternative Investment Market as a Model

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Abstract

What are the necessary conditions for strong and trustworthy stock markets? Most people assume that markets require a strong set of government rules and regulations to eliminate problems associated with transparency and fraud. Commonly overlooked is the fact that stock exchanges did, and to a large extent still do, provide a set of private rules and regulations. One modern stock exchange that relies heavily on private rather than government regulation is the London Stock Exchange's Alternative Investment Market (AIM). Founded in 1995, AIM is an exchange-regulated market in which private regulators, called nominated advisers or nomads, oversee individual firms and decide whether they can list their shares. This system of private regulation reduces regulatory barriers and has attracted many new firms. But rather than engaging in a race to the bottom" in which anything goes, the private regulators work to put their stamp of approval only on firms that warrant trading. The market has attracted a lot of investment, and the survival rate of initial public offerings (IPOs) is in line with that of other more regulated markets. This system of private regulation gives more firms access to capital markets and more choices to investors, and it can be viewed as a model for other markets to follow.

Keywords: Financial Services Authority, United Kingdom Listing Authority, Securities Exchange Commission, self-regulatory organizations, financial deregulation, private governance

JEL codes: G100; G180; G380

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1. Introduction

Almost all economists agree that stock markets are a good thing for firms and investors. They help to channel money from savers (however small) to firms that desire capital, enabling savers to share in a firm's success. Everyone can gain. A matter of debate, however, is what conditions are necessary for stock markets to flourish. Although investors and those entrusted with their money (the invested-in company's board of directors and its officers) theoretically have the same long-term interest in making investments succeed, their agents might skimp on fiduciary duties to maximize the investor's desired returns, or they might engage in deliberate fraud. Such problems decrease confidence in markets and lead to fewer mutually beneficial investments taking place (Prentice, 2002). To eliminate such problems, people may look to government "to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation" (Securities Exchange Commission, 2012). Rajan and Zingales (2004, p.283) write that "markets cannot flourish without the very visible hand of the government, which is needed to set up and maintain the infrastructure that enables participants to trade freely with confidence."

To some people, the choice is between government oversight and no oversight, and the latter sounds undesirable. What they overlook is third-party oversight from the private sector, which historically was the norm. If rules and regulations are beneficial, private parties can contract to have them.

Until the past hundred years, the world's major stock exchanges were regulated privately, and in many areas they continue to be. A stock exchange is in business to facilitate exchange (people go to it because trading in the exchange is more attractive than trading elsewhere), and those in control of an exchange can enhance the demand for their market by providing assurances to investors with private rules and regulation. Mahoney (1997) refers to this role of the exchange as the regulator, and other economists describe the rules of stock exchanges as an important part of the microstructure of markets (Neal and Davis, 2006). Romano (1998) argues that a system of private regulation allows potential investors to opt into stock exchanges with rules and regulations that they trust. Stock exchanges without good assurances (or, on the flip side, with onerous regulations) will lose potential investors, creating incentives for stock exchanges to create an environment attractive to investors.

The world's first formal, rule-enforcing stock exchange was created when eighteenth-century stockbrokers transformed coffeehouses in London into a private club (Stringham, 2002). The club catered to more reputable brokers and created entrance requirements, and it banished those who intentionally or unintentionally defaulted. With these new assurances, the club's trading venue evolved through Garraway's Coffeehouse and Jonathan's Coffeehouse, to New Jonathan's, to the Stock Subscription Room, and eventually to the London Stock Exchange, whose members adopted as their motto, "My word is my bond."

Today, even though some stock exchanges are run or controlled by government (Daniel, 2010), almost all have private rules and regulations of varying degrees. One stock exchange that relies on a high degree of private regulation is the London Stock

Exchange's Alternative Investment Market (AIM). The London Stock Exchange sets the rules and regulations for the exchange, while nominated advisers known as "nomads" act as private regulators to ensure that these rules are followed. These nomads are basically paid (directly by the firm but indirectly by the investors) to ensure that a firm is legitimate before giving it a stamp of approval to go public; if a firm is not legitimate, this damages the reputation of the nomad who endorsed the firm.

The system of private regulation at AIM has many benefits. In contrast to a system of bureaucratic rules and regulations that hinders legitimate firms from going public (Stringham, Boettke, and Clark, 2008), the private regulations are much more flexible and enable many smaller firms to access capital markets. Even as American commentators are declaring that the "mounting pile of regulations forced the IPO [initial public offering] market to shrink" (Patricof, 2011), the IPO market for AIM has been flourishing. Beginning in 2001, the number of IPOs in England exceeded the number of IPOs in the United States for the first time in decades, and from 2001 through 2010 the number of IPOs on AIM has equaled or exceeded the number of IPOs on the American Stock Exchange, NASDAQ, and the New York Stock Exchange combined (London Stock Exchange, 2012c). Some people debate why IPOs have gone down in the United States, but Piotroski and Srinivasan (2008) found that small foreign firms were less likely to cross list in the United States because of the high regulation barriers from regulation in the Sarbanes-Oxley Act.

AIM attracts many small firms accessing the stock markets for the first time, and many firms already listed on other exchanges have chosen to switch to AIM. The "firms transferring to the AIM often [cited] lower costs (31.7%), flexibility (20.3%), and minor

regulation (16.3%)” (Vismara, Paleari, and Ritter, 2012, p.18). To many advocates of regulation, this should be a recipe for disaster. But even though AIM does not have the same amount of regulation as other markets, the survival rate of IPOs on AIM is in line with the survival rates of IPOs on more government-regulated markets in the United States (Espenlaub, Khurshed, and Mohamed, 2012).

At a time when politicians and lawmakers are imposing more and more regulations (*The Economist*, 2012a, 2012b), it may be useful to take a step back and analyze a less bureaucratic alternative. Private regulation allows investors to select the set of rules and regulations that they prefer rather than government imposing a set of often questionable and costly regulations on everyone. Even if one assumes that the Securities Exchange Commission provides a beneficial framework for some or even most investors (an assumption that we, like Stigler [1975, p.87] would debate), it does not follow that all investors should be prohibited from opting into alternative regulatory frameworks such as those on AIM. This article provides an overview of AIM, describes how the private regulation works, and summarizes how the market has performed. We conclude that the London Stock Exchange’s AIM can be viewed as a model for others to follow. Provision of rules and regulations by a monopolist regulator is overrated.

2. Streamlined and Low-Cost Private Regulation on the London Stock

Exchange's AIM

a. Listing on AIM

The London Stock Exchange's AIM must comply with certain government rules.¹ But AIM is classified as an exchange-regulated market, so many European Union directives and the United Kingdom's Combined Code on Corporate Governance do not apply (Mendoza, 2008). Most of the regulation comes from a combination of the London Stock Exchange itself and from AIM's approved nomads, which are typically investment banks or other financial services firms with experience in helping other firms to go public (*Financial Times*, 2006).

The London Stock Exchange sets the rules and must approve companies as nomads. Such companies must: 1) "have practiced corporate finance for at least the last two years," 2) "have acted on at least three relevant transactions during that two-year period," and 3) "employ at least four 'qualified executives'" (London Stock Exchange, 2012a). Nomads must be members of a "firm of experienced corporate finance professionals approved by the Exchange," (London Stock Exchange, 2010b) which prevents fly-by-night organizations or "anything goes" firms from becoming regulators. As a residual claimant on the success of the market, the Exchange does not want to approve private regulators who will undermine the reliability of AIM. At the same time, the Exchange has an incentive to approve any private regulator who is likely to enhance the value of the market.

¹ For example, as required by the Financial Services and Markets Acts of 2000, the Financial Services Authority reviews the prospectus for each company, and firms associated with the market can still be sued by government.

The next decision is determining which firms can list their shares. In a market with unlimited entry and without any rules or regulations, one can imagine all sorts of private fraudsters promising everything and delivering nothing but bad things. To prevent that from happening, the nomads are hired basically as private gatekeepers to decide whether companies desiring to list are “appropriate for the market.” The nomads also monitor companies to ensure that exchange-regulated corporate governance standards are met (London Stock Exchange, 2010b).

Although other markets have numerous bureaucratic rules and regulations regarding when a firm can go public, AIM’s requirements are much more flexible. AIM has “no minimum market capitalization, no trading record requirement, no prescribed level of shares to be in public hands, no prior shareholder approval for most transactions, admission documents not pre-vetted by the Exchange nor by the UKLA [U.K. Listing Authority] in most circumstances” (London Stock Exchange, 2010a, p.6).

The IPO process on AIM is quite streamlined, and a typical IPO takes from three to six months (London Stock Exchange, 2010a, p.23). Companies already traded on other approved exchanges are eligible for a fast-track option for joining AIM, which takes five to eight weeks (Withers Worldwide, 2012). For a typical IPO, the nomad submits an admission document (see Figure 1), which provides disclosure and other information potentially relevant to investors. The privately produced disclosure requirements include “Operating and Financial Review, Capital Resources, Research and Development, Patents and Licenses, Profit Forecasts or Estimates, and Remuneration and Benefits” (London Stock Exchange, 2010b). The nomad also prepares a legal due-diligence report, a working capital report, historical financial information, pro forma financial information,

and a report on financial reporting procedures (Hanson Westhouse, 2012). Each of these documents must be available for potential investors for various periods of time, such as 10 to 14 days, before a firm can be admitted (London Stock Exchange, 2010a, p.25). If there are any changes in a firm's "financial or trading position between the balance sheet date of its latest published financial information and the date of the admission document" that could affect the price of the security, AIM's Rules for Companies require the firm to disclose this information in the admission document (London Stock Exchange, 2010a, p.36). In addition to helping to coordinate the initial due diligence process for an IPO, a firm's nomad also provides ongoing consultation, advice, and review (London Stock Exchange, 2012b).

Table 1: Contents of an AIM Admission Document

The very front	<ul style="list-style-type: none"> • cover page, including certain "health warnings" and important information for non-UK investors • summarized key information in relation to the company • index • list of directors and advisers • list of definitions and glossary of technical terms • timetable • placing statistics
The front end: Detailed description of the business and the investment proposition	<ul style="list-style-type: none"> • history of the business • information about the present-day business, current trading, and investments • key business and market trends and prospects in the case of an investment company; details of its investment strategy • summarized information about directors and key personnel • intellectual property • information about the placing or offer for subscription • use of funds • corporate governance policies • share option arrangements and dividend policy • City Code information (if applicable)
Risk factors	<ul style="list-style-type: none"> • risk factors relevant to the business
Historical	<ul style="list-style-type: none"> • historical financial information relating to the company and its

financial information	<p>subsidiaries—usually audited accounts for the last three years or a shorter period of time if the company has been in existence for less than three years. If more than nine months have elapsed since the company’s financial year end, interim financial information also must be included, which may or may not be audited.</p> <ul style="list-style-type: none"> • an auditor’s or reporting accountant’s opinion as to whether the financial information shows a true and fair view for the purposes of the AIM admission document • if appropriate, pro forma financial information
Other reports	<ul style="list-style-type: none"> • experts’ reports; these are necessary for mining and oil and gas companies, and they may be desirable for a company with a specialist business (e.g., technology, life sciences, intellectual property).
Statutory and general information: The back end	<ul style="list-style-type: none"> • a responsibility statement confirming that each of the directors and proposed directors accepts general information: responsibility, individually and collectively, for the information contained in the document, and that to the best of their knowledge and belief (having taken all reasonable care to ensure that such is the case) the information contained in the admission document is in accordance with the facts and does not omit anything likely to affect the import of such information • details of the incorporation and legal status of the company, its registered office, and its objects • information about share capital, including rights attaching to the shares and authorities to issue • further shares • information about the company’s articles of association and constitution documents • directors’ interest in the company, directorships of other companies, and involvement in previous personal or company insolvencies • the name of any person who, so far as the directors are aware, holds an interest of 3 percent or more in the company’s issued share capital and the level of that interest • share option plans • material contracts, including the placing or introduction agreement • related party transactions • terms of engagement of the directors and senior personnel • summarized tax position

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- statement by the company’s directors that, in their opinion, having made due and careful enquiry, the working capital available to the company and its group will be sufficient for its present requirements, i.e., for at least 12 months from the date of admission of its securities to AIM
 - material litigation
 - any “lock-in” statement required by the AIM Rules or the nomad
 - level of dilution resulting from any offer
 - expenses of the issue
 - terms and conditions of any offer for the sale of shares
 - sundry information

Source: London Stock Exchange, 2010a, p.40

On the front of the admission document, firms are required to print two warnings: “AIM securities are not admitted to the official list of the United Kingdom Listing Authority” and “The London Stock Exchange has not itself examined or approved the contents of this document” (London Stock Exchange, 2010b, p.17). Following the guidelines recommended by a 1992 Cadbury Committee report from the London Stock Exchange and the U.K. Financial Reporting Council (Seidl, Sanderson, and Roberts, 2012), AIM gives firms a comply-or-explain option for rules. The comply-or-explain rule allows companies to comply with any rule given by the market regulators or to explain why they should not follow this rule. If certain rules are inapplicable or inappropriate for a certain firm, this provides a way for the firm to skip them. AIM companies (London Stock Exchange, 2010a, p.67) are encouraged, but not required, to follow the U.K. Corporate Governance Code.

b. The Costs of Listing on AIM

An advantage of private versus government rules is that private regulators have incentives to weigh more precisely how much investors are likely to value a rule (such as requiring information) versus how much it costs investors. Government is less incentivized to accurately measure the burdens it imposes.

Table 2 provides a summary of the costs of going public as well as continuing listing costs for a firm selling \$50 million in shares on AIM versus NASDAQ. Not only are the initial costs of going public on AIM \$1 million less, but firms will save upward of \$2 million annually going forward because they avoid regulations such as those associated with SOX. The majority of foreign companies listed on AIM (104 of 157) chose to list on AIM between 2004 and 2005 (Rousseau, 2007, p.54), which coincides when the onerousness of the Sarbanes-Oxley regulations passed in 2002 became evident. In the words of one broker, “You guys should erect a statue to SOX outside the LSE” (quoted in Grunfeld, 2006).

Table 2: The Cost of Listing on AIM versus NASDAQ

<i>Direct Listing Costs</i>			
<i>AIM IPO</i>		<i>NASDAQ IPO</i>	
Nomad/Broker Fee	2,000,000	Underwriting Fee	3,500,000
Corporate Finance Fee	500,000	Legal Fees	500,000
Company Counsel	262,000	Miscellaneous Expenses	145,000
Nomad Counsel	300,000	Printing Fees	75,000
Accounting Fees	312,000	Accounting Fees	65,000
AIM Fee	7,300	NASDAQ Listing Fee	100,000
Registrar Fee	45,000	SEC and NASD Registration Fees	107,000
Total	\$3,426,300	Total	\$4,492,000
<i>Indirect Ongoing Costs</i>			
<i>AIM</i>		<i>NASDAQ</i>	
Nomad Fee	90,000	SOX Compliance	3,500,000
AIM Annual Fee	7,300	NASDAQ Annual Fee	17,500
Accountants	50,000		
Total	\$147,300	Total	\$3,517,500

Source: Mendoza (2008)

c. AIM IPO Data

The number of IPOs in London has recently surpassed that of its competitors. Figure 1 presents the total number of IPOs on the London Stock Exchange, New York Stock Exchange, and NASDAQ for the past few years. By this account, the London Stock Exchange and its AIM have been quite successful.

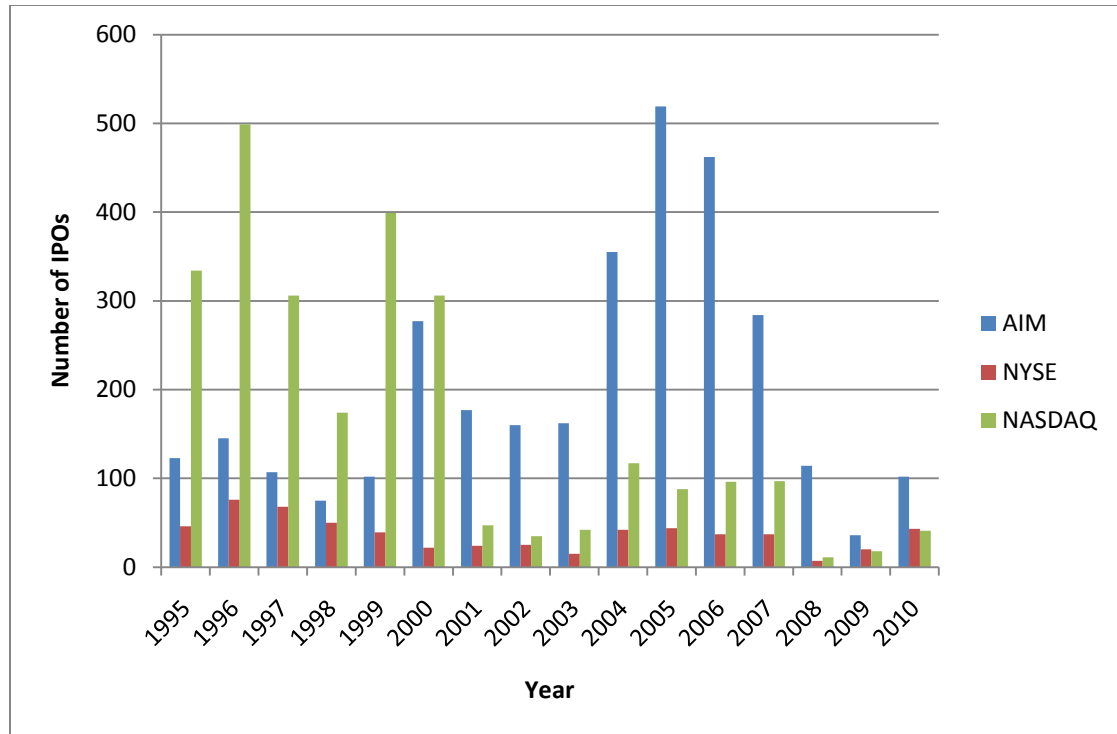


Figure 1: IPOs on the London Stock Exchange AIM Market, New York Stock Exchange, and NASDAQ

Source: Data are from AIM Market Statistics, 2012, and Ritter, 2011

The market attracts firms not just from the United Kingdom but from many countries. As the vice president of one Canadian brokerage firm, Mark Maybank, stated, “Everywhere we go in the US or Canada to meetings with potential clients, investors or venture capital companies, the only thing that people want to talk to us about is AIM. We’re coming into deals that five years ago would have been part of a drip-feed onto NASDAQ. Now that’s flipped completely” (quoted in Dey, 2006). In the words of another financial commentator: “AIM is flourishing and companies from around the world are coming to London exactly because the dead weight of regulation is so much greater in their own markets” (*Financial Times*, 2006).

With the economic downturn starting in 2008, all markets, including AIM, saw a decrease in the number of IPOs and downward movement in the market capitalization of listed firms. Figure 2 shows the number of companies on AIM as increasing from 10 companies in 1995 to 1,122 companies in 2012. The number of total firms has decreased from its peak in 2007, with some of the firms going bankrupt, some being acquired by other firms, some going private, and some moving to other exchanges such as the London Stock Exchange's main market. As a result, the total market capitalization on AIM is down 27 percent from its peak five years ago (Figure 2). However, as we will discuss in the next section, as of 2012, the London Stock Exchange and AIM are experiencing recoveries similar to those of competing markets.

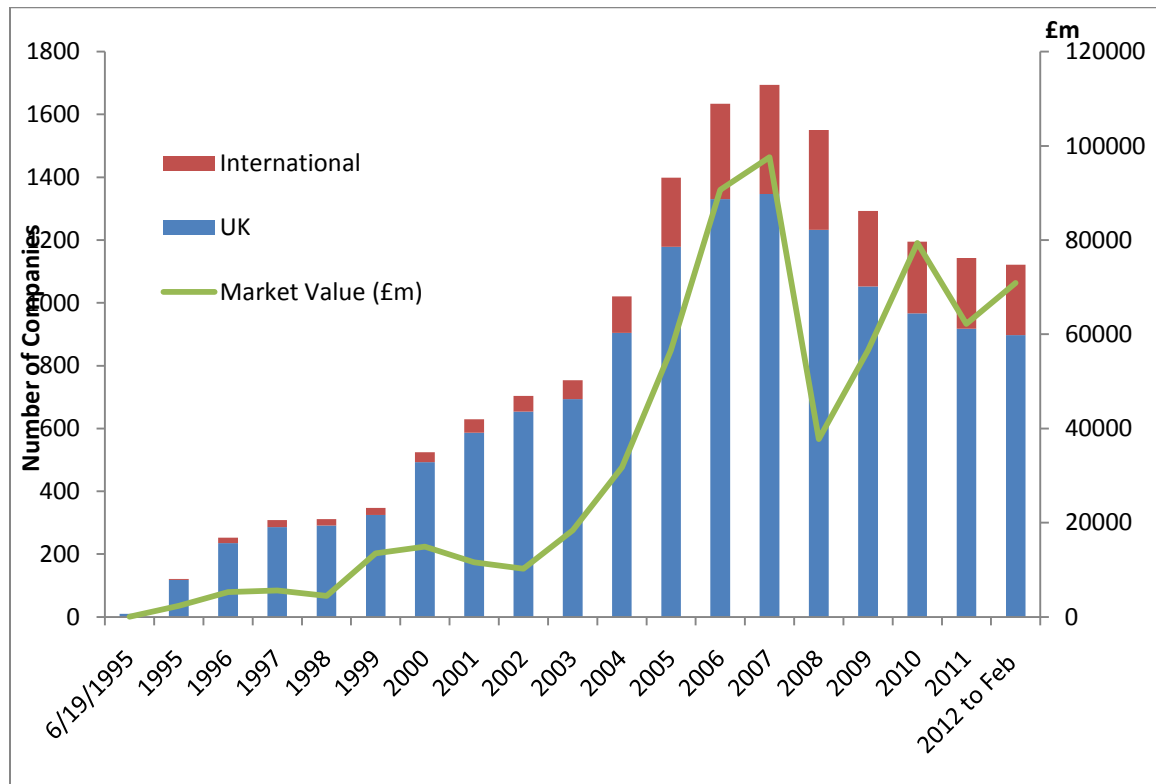


Figure 2: Number of Companies and Market Value of Firms Listed on AIM

Source: Data are from AIM Market Statistics, February 2012

3. Effective Private Regulation on the London Stock Exchange's AIM

AIM clearly has attracted many new firms. As measured by the number of deals and amount of money raised, AIM appears to be a clear success. But what about cases of fraud and the bankruptcy of some of these firms? There are two potential sources of failure: honest but unintentional firm failure and deliberate fraud. Both result in shareholders losing money. Securities fraud occurs when investors are given false information that induces the buying and selling of securities. Oftentimes, people debate about whether a firm going into bankruptcy deliberately committed bad choices or just made poor but well-intended business decisions. Without knowing what managers were thinking, sometimes we cannot easily disentangle the two, but the two together can be measured by looking at firms' survival rates.

In AIM's case, the firms which are going public get to select the firms that regulate them. Advocates of centralized government regulation argue that allowing competition among regulators can allow firms to shop for regulators that allow them to bend or ignore good rules (Coffee, 1995). London's *Sunday Business* (2007) reports, "Critics claim that AIM, with 1,634 constituents with a combined market value of £90.66bn to the end of 2006 and including 306 non-British firms, is a dustbin for poorly-run businesses." In 2007, former SEC commissioner Roel Campos accused AIM of creating a market like a casino (Treanor, 2007). In the past five years, the number of firms listed on AIM has gone from a peak of 1,694 to 1,122 today (AIM Market Statistics, 2012).

Espenlaub, Khurshed, and Mohamed (2012) conducted a study of the IPO survival rate² of firms going public on AIM and found it to be very much in line with the survival rate of firms going public on more regulated exchanges. From a comparative point of view, even though firms traded on AIM have had their successes and failures, they do not appear to be significantly different from firms traded elsewhere as a result of fewer government regulations. Khurshed, Paleari, and Vismara (2012) note that AIM firms use IPOs mainly to finance growth and have a high level of equity retention. Critics of AIM companies may highlight the relative illiquidity of AIM shares to larger exchanges. On average, however, AIM firms have greater liquidity than they would otherwise have on other exchanges (Litvintsev, 2009, p.26).

Is AIM a good place for firms to raise capital but also a place where investors are more likely to be swindled? It must be recognized at the outset that no stock market, however regulated, can ever be 100 percent free of some of its listed firms going broke (nor should it be, since that is how markets work). The whole point of stock markets is that they allow investors to become partial owners of firms, giving them the potential both for greater risks and higher returns. Putting the issue of fraud aside completely, markets for small-cap firms can be especially risky. Nevertheless, although many firms were delisted from AIM (Matthews, 2011), many were simply purchased (Dawber, 2010), which in no way is an indication of failure.

² The survival rate is the percentage of firms that stay listed on the stock exchange a number of years after going public.

Figure 3 plots the performance of the FTSE AIM All-Share Index³ versus the Dow Jones Industrial Average. One contains very small firms, and the other contains established blue chips, but both have had their ups and downs over the past ten years. The AIM All-Share Index possesses higher variance but not a substantially worse or better performance overall. Even though many small-cap firms traded on the more privately regulated AIM have faced tough times in recent years, as have firms on more regulated markets. Yet AIM has enabled many smaller firms to raise money and has provided more investment outlets to investors.

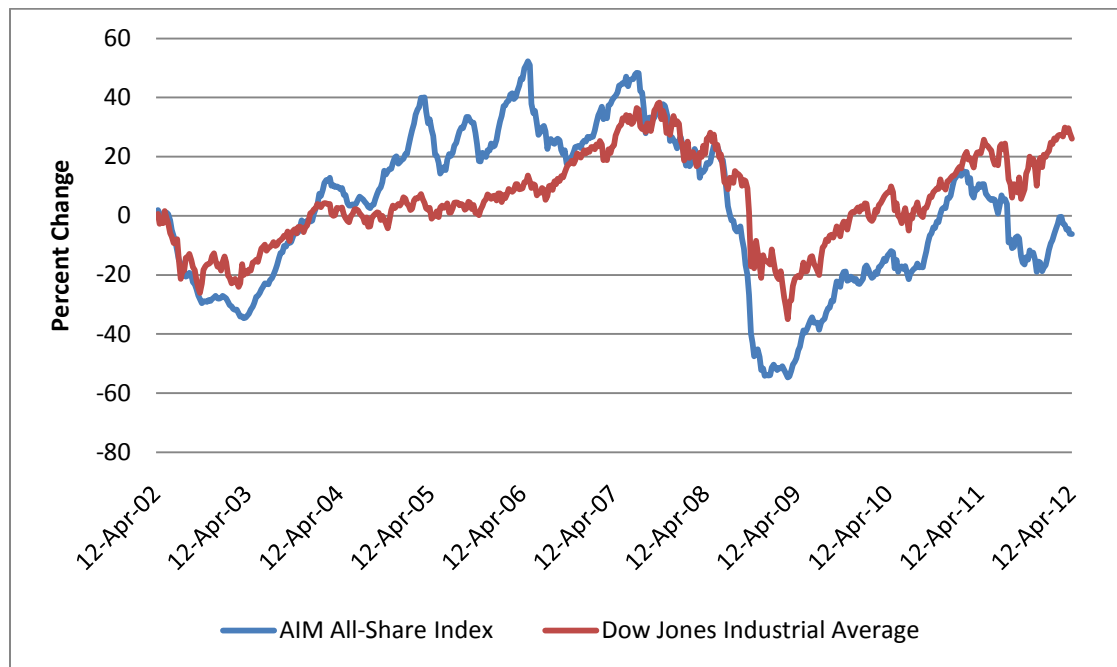


Figure 3: Performance of All Firms Listed on AIM Compared with the Dow Jones Industrial Average

Source: Data are from Google Finance Historical Prices, 2012

Why have failure and fraud not run rampant, as the “race to the bottom” theorists would have predicted? Even though nomads are hired by the firms that they regulate, both the London Stock Exchange *and* investors must approve these regulators. The

³ This is an index created by the *Financial Times* and the London Stock Exchange for all equities listed on AIM.

London Stock Exchange is the first gatekeeper, and it can expel a nomad for improperly fulfilling its role. The second gatekeepers are the investors, many of whom are institutional and have repeated experience with the nomads. If a nomad establishes a reputation among listing firms for laxity in its regulatory duties (the race to the bottom), that reputation can be transmitted easily to investors. Although investors may find it difficult to fully investigate each of the thousand-plus firms listing shares, they can more easily see if a nomad is consistently peddling fraudulent firms.

As Mendoza (2008, p.318) states, “Nomads build their reputational capital by servicing clients over prolonged periods of time, and ultimately pledge this highly valuable asset to vouch for the suitability of AIM companies and the accuracy of their disclosures to the market.” Nomads include widely recognized firms such as Deloitte and Touche, PricewaterhouseCoopers, J. P. Morgan, Morgan Stanley, and HSBC Bank. Each of these firms has significant reputational capital that it does not want to risk.⁴

Furthermore, to continually improve its regulations, the Exchange has formed the AIM Advisory Group to provide input from nomads, brokers, advisers, and market participants (London Stock Exchange, 2012a). In this way, AIM can continually receive feedback from its community to encourage and develop its operational efficiency and regulations.

The amount of fraud will never be zero, but AIM has effectively kept its level quite low. Fraud could only be completely eliminated by having no transactions. Since the founding of the exchange in 1995, AIM has experienced four major instances of alleged fraud. The first involved Langbar International, which in 2005 had its shares suspended from trading and was put under investigation by the Serious Fraud Office for

⁴ For a discussion on the role of reputation, see Shearmur and Klein (2007).

allegedly defrauding investors of £570 million (Mason, 2011). Appropriately, this led to negative repercussions against Langbar International's nomad, Nabarro Wells. In October of 2007, AIM fined Nabarro Wells £250,000 because it had "failed to undertake the necessary level of due diligence to assess the appropriateness of certain companies for admission to AIM" (Kennedy, 2007). Following the incident, Nabarro Wells recorded a loss of £300,000, as compared with the previous year's profit of £183,000, and in April of 2008 Ambrian Capital acquired Nabarro Wells for less than £1 million (*The Evening Standard*, 2008).

The second largest fine issued by AIM was in 2009 on a nomad named Blue Oar Securities. In that case, an air conditioning company, Worthington Nicholls, had floated shares at 50p in 2006 and seen them rise to 194p in 2007. But by 2008 financial shortfalls emerged, and Worthington Nicholls shares fell to 10p. AIM conducted an investigation and found that Worthington Nicholls had "made announcements to the market which were misleading and/or omitted material information" between 2006 and 2007. AIM publicly censured and fined the nomad Blue Oar £225,000. Disgraced, Blue Oar ended up changing its name to Astaire Group and divesting its main division, Astaire Securities, for £2.45 million in 2010 (Bates, 2010; Taylor, 2009). One article in *The Telegraph* (2009) concluded, "After all, few things like a good public flogging serve to remind brokerage houses to show a little caution in who they bring to market in the first place—and the importance of never, ever misleading investors." Another commentator said, "People will admire them [AIM] for taking a tough line," which makes sense because AIM does not want to see the value of its market tarnished.

Although critics could argue that these cases of fraud are a failure of the model, it should be recognized that no system, including extremely regulated markets, has prevented 100 percent of fraud. If anything, the fact that only four known major instances of fraud have occurred among the more than 3,200 firms that have traded in the history of AIM indicates that AIM has been fairly successful in keeping fraud to a minimum. John Pierce, CEO of the Quoted Companies Alliance, notes that for every fraudulent company “there are hundreds of [AIM] success stories with upstanding management teams working earnestly in the interests of shareholders” (quoted in Taylor, 2009). To be precise, the ratio is 1:800. The cases of fraud are quite contained and have not cascaded downward as the “race to the bottom” theorists would have predicted.

4. Conclusion

The London Stock Exchange’s AIM is a prime example of a modern successful privately regulated market. Rules and regulations may be beneficial and necessary, but there is no reason that they must come from the state. Rather than placing regulatory decisions in the hands of politicians and bureaucrats, the London Stock Exchange’s AIM puts those decisions in the hands of private regulators. Most government regulations are applied to everyone with little or no regard to the burden they impose or whether they actually have any benefits. A system of private regulation, in contrast, is flexible. It allows rules and regulations to be determined by parties who have the most at stake in seeing a market succeed. Doing so allows private regulators to experiment and thus to discover what sets of rules and regulations investors value most. Those that fail to adopt good rules or that adopt burdensome will lose investors. Competition thus encourages a race to the top.

Most people accept that competition fuels innovation and lowers costs in other areas, and the London Stock Exchange's AIM indicates that the same is true for rules and regulations for markets. AIM's system shows that flexible private regulation can serve firms and investors better than bureaucratic government regulation. As they are market participants who are paid to help markets succeed, private regulators have an entirely different set of knowledge and incentives than government regulators. The London Stock Exchange's AIM has grown tremendously since its inception, and much of this growth can be attributed to its system of private, flexible, and low-cost regulations. This system has allowed many firms to access capital and has given more options to investors. Despite the fact that (or perhaps because) the market relies heavily on private regulation rather than government regulation, it is not significantly more prone to problems than any other market. AIM shows that rules and regulations can successfully come from the market.

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