Notes on a flawed study

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(Opinions expressed herein are strictly those of the author)

In October 2012, Investor Responsibility Research (IRRC) Institute and ISS, the proxy management firm, jointly published a study purporting to assess the relative performance of controlled companies listed on exchanges in the United States (the S&P 1500 Composite Index).

The study has received little notice in the Canadian media (but for the ***Globe and Mail***, October 4th 2012) but circulates widely in the financial community as its «findings» buttress the prejudice against dual class share structures.

Unfortunately, that study is *sloppy* in design, *amateurish and misleading* in its statistics, *biased* in its interpretation and ***irrelevant*** *for Canadian companies*. Had that report been submitted as a term paper by first-year MBA students, it would have received a fail grade.

The statistical findings of this so-called research are summarized in the following table (page 8 of their report).

Total Shareholder Return (TSR) per IRRC/ISS Study

Ownership	1-Year Avg. TSR	3-Year Avg. TSR	5-Year Avg. TSR	10-Year Avg. TSR
Non-Controlled	**14.81**	**12.96**	**1.22**	**9.76**
Controlled	**16.33**	**13.08**	**1.55**	**9.28**
Controlled: Multiclass	**17.48**	**12.35**	**0.93**	**7.52**
Controlled: Single class	**13.78**	**14.91**	**3.31**	**14.26**

The authors should have conceded that, indeed, controlled corporations produce better results than non-controlled ones. Yet one of their key findings reads as follows «***Contrary to theory, non-controlled firms outperform controlled firms over a 10-year period***». On the basis of an average TSR of 9.76 versus 9.28, surely a non-significant difference! Nothing reveals more clearly the biased authorship of this report.

By splitting the companies in two groups, controlled through a dual class of shares or controlled with a single class, they discover that the former group does not perform as well as non-controlled corporations, except for the one-year results.

They fuss over this result to argue that their study contradicts the «theory» that controlled corporation can plan and manage with a long-term perspective. How anyone can write such nonsense on the basis of these results boggles the mind.

Note the fatal flaws of this study:

- no statistical tests are carried out to check if any of these differences were significant;
- the table reports the «average» and does not show, as any competent researcher would, *the median* for each group (The median gives the value that divides a sample in two equal groupings; it is not sensitive, as the average is, to a few extreme cases pushing the average up or down.);
- It is sloppy not to reveal that some corporations have become public less than 10 years ago and therefore could not be included in their 10-year TSR. Of particular importance is the absence of Google with an eight-year history as a public corporation and TSR of 600% for that period;
- Any statistical analysis of minimal relevance would seek to control for the influence of several variables: type of industry, age of corporations, disproportionate representation, etc.

Remarkably, when a particular result does not jive with their prejudice, the authors suddenly discover the limitations of across the board comparisons.

Faced with the result that the median CEO compensation (note that they do know what a median is all about but fail to report the medians for their most important table; any reason??) is lower in controlled corporations than in non-controlled corporations they cannot accept this as a fact because:

«…comparisons of compensation at controlled versus non--controlled firms are ***confounded*** *by factors such as* ***differences in***

market capitalization for the two groups, disproportionate representation from certain industry groups and the absence of others, and insufficient sample sizes within controlled firm industry groups. (Report, page 11, emphasis added)

But the overall results for Total Shareholder Return would not be confounded by the same factors!

They try to wiggle out of their discomfort with the result on CEO compensation, not by carrying out a proper multivariate analysis, but by picking a particular group of companies in the Media industry because of the similarities in size of the two groups (controlled and non-controlled firms).

Lo and behold, they find that the controlled companies pay their CEO more than the non-controlled companies. Pleased as punch with their demonstration, they do not favour the reader with the TSR performance of these two groups of Media companies.

The whole report is contaminated by the authors' bias and their unwillingness (or incapacity) to conduct a proper statistical analysis of the results. As it stands, this report is worthless.

Shareholder Rights and Takeover Defenses

The report reviews the takeover defenses in controlled and non-controlled corporations. Not surprisingly, they find these measures (in particular classified boards, and supermajority requirements), which protect management rather than shareholders, are far more frequent in non-controlled corporations.

Irrelevant for Canada

The Canadian legal and regulatory context for dual class companies is different from the U.S. context in a very significant way: almost universally in Canada, listed corporations with a dual class of shares have adopted a «coat-tail» provision. It is a requirement of the TMX stock exchange since 1987.

This provision ensures that the controlling shareholder (through a class of shares with multiple votes) cannot sell the control of the company without minority shareholders receiving the same price for their shares as did the controlling shareholder.

The U.S. does not have an equivalent requirement.