Institute for governance
of private and public organizations

The Case for Dual-Class of Shares

—

Policy Paper Nº 11

2019

Toward Value-Creating Governance®

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Policy Paper N° 11

Prepared and written by

Yvan Allaire, PhD (MIT), FRSC
Executive Chair of IGOPP

2019

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Message of the Executive Chair

This policy paper, the eleventh of a series, received the unanimous approval of the IGOPP board of directors[1] on December 19th 2018.

For the second time, IGOPP is outlining proposals to enhance the value of dual-class companies for Canadian society.

The IGOPP is indeed fortunate to count on experienced and judicious board members to shape our policy positions. I wish to express my warmest gratitude to the IGOPP board members who have accepted to participate to the working group given the task to put together this policy paper. The informed exchanges among group members, their years of high-level experience with dual-class companies were indispensable to the production of this policy paper.

The members of the working group were:

- Yvan Allaire, chair
- Stephen Jarislowsky
- Michel Magnan
- Claudine Mangen
- Andrew Molson
- Robert Parizeau
- Guylaine Saucier
- Sebastian van Berkom

With many thanks,

Yvan Allaire, PhD (MIT), FRSC
Executive Chair of the Board of Directors

1 Mr. Louis Morisset, CEO of the Autorité des marchés financiers du Québec abstained as per the policy of his organization.

Executive Summary

There are now 69 dual-class companies listed on the Toronto Stock Exchange, down from 100 in 2005. Only 23 Canadian companies went public since 2005 with a dual-class of shares while 16 of the 100 have since converted to a single-class and another 38 have disappeared since 2006 for other reasons (acquisitions, mergers, bankruptcies and so on).

The arguments pro and con these types of capital structures are numerous and in some ways compelling. Thus, on the one hand, the increased activism of funds (including the so-called "activist" hedge funds) pushing and shoving boards and management of companies to boost share price and/or sell prematurely the business has reinforced the determination of entrepreneurs to insulate themselves against such pressures by adopting a dual-class of shares at IPO time (more so in the USA than in Canada).

On the other hand, index funds and ETFs, now large and growing «investors»[2] which are obliged to closely track the market value composition of a particular stock index, thus may not manifest their discontent about a corporation by simply selling its shares. They must wield influence on corporate management through their voting power (which is restricted in dual-class companies) and by loudly voicing their frustration and disagreement. Not surprisingly, these latter investors are ferociously hostile to dual-class of shares and have been strident lately in their opposition, urging, successfully, the index providers (i.e., Dow-Jones, etc.) to exclude from their indices in the future any company with unequal voting rights.

They are also lobbying, not yet successfully, the SEC to prohibit this type of capital structure. Their latest gambit, promoted by *The Council of Institutional Investors*, would impose a *mandatory time-based sunset clause of seven years*. Of course this term could be renewed by a majority vote of all classes of shareholders!

The issue of "sunset clauses" has thus gained salience as institutional shareholders and various agencies try to curtail, rein in, and put a time limit on the relative freedom that a dual-class of shares provides to entrepreneurs and family corporations.

As a consequence, in recent times, the simmering feud between the church of the "one share-one-vote" and the heretic believers in shares with unequal voting rights has boiled over particularly in the USA.

Some Facts

- There is no incontrovertible evidence that dual-class companies underperform, in financial or stock market terms, traditional one-share-one-vote companies or are penalized by some discount on their value. Actually, *quite the contrary may be more likely according to recent studies, which tend to show superior performances achieved by dual-class companies*.

2 The three major American managers of ETFs (Vanguard, BlackRock and State Street) in 2017 held 18% of all shares of the S&P 500 companies (Fichtner, Heemskert et Bernardo Garcia, 2017).

Table A

Empirical studies of the relationship between dual-class capital structure and company performance (2007 to 2018)

Impact of DCS on performance	Studies	
	Number	%
Favorable or neutral	18	49%
Unfavorable	19	51%
Total	**37**	**100%**

Source: IGOPP compilation, 2018.

- Canadian dual-class companies have almost all adopted a "coattail" provision (a feature largely absent in the USA), which ensures that all classes of shareholders will receive the same price for their shares, should the controlling shareholders decide to sell out. That twist, by itself, has removed most of the potential "private benefits of control" through a dual-class of shares.
- In the coming years, a battle will rage about *sunset clauses*, particularly of the time-based sort. An organized effort is already afoot, led by the *Council of Institutional Investors*, an influential American organization, to make it mandatory for future dual-class companies to adopt a time-based sunset. At a minimum, companies considering a dual-class IPO will be urged by investment bankers and sundry influencers to include some time limit on the benefits of superior votes. A movement may even emerge to pressure (or compel) dual-class companies to adopt **a time-based sunset** *long after their IPO*.

  In their pursuit of voting power, these proselytes are prepared to forego the benefits and durability of family companies, which we chronicle in this paper. They believe, and that is a belief firmly grounded in self-interest among fund managers of various sorts and among "efficient-market" ideologues in Academia, that an economic system thrives on creative destruction and survival of the fittest, that a company is but a "property" and that stakeholders other than shareholders may become unfortunate collateral damages. That worldview is injurious to companies as well as to the societies where they are located.

  Dilution sunset clauses, whereby the multiple voting shares revert to single votes when the controlling shareholder's voting power falls below a given threshold, are already fairly common in Canada. We recommend that future dual-class companies include such a clause but designed so that it is triggered only when the controlling shareholder's voting power falls

below the level required to assure a blocking level of votes (33.3%).

With a 4:1 superior voting ratio (recommended by IGOPP), the dilution sunset would be triggered if the entrepreneur controls less than 11.1% of the equity!

As for **time-based sunsets**, for all their superficial plausibility, they could actually turn out to be damaging to companies and to the broader society. Let's look at three iconic Quebec-based corporations and the consequences if a time-based sunset (say 10 years) had been the norm or the rule in Canada a long time ago:

Table B

Three iconic Quebec-based corporations according to their market value, number of employees and year of IPO

		Market value		Number of employees	
	Year of IPO	10 years later	Today*	10 years later	Today*
CGI	1986	~$2.B	$21.1B	~8 000	74 000
ACT	1995	$4.3B	$39.4B	36 000	120 000
Bombardier	1969	~$40M	$5.4B	6 000	60 600

Note: M: Millions of current Canadian dollars B: Billions of current Canadian dollars
*As of November 30th 2018

Source: IGOPP compilation, 2018.

Had these companies been obliged at IPO time to adopt a time-based sunset, their controlling shareholders might well have decided to remain private companies, forego access to public funds, and limit their growth to whatever alternative funding would sustain. Had they decided to go ahead and include a 10-year sunset clause, these companies would have been taken over a long time ago and turned into some form of branch plant limited to serving the local market!

Some advocates of sunset clauses put forth the optimistic argument that shareholders of both classes *may well vote for a renewal of the time-based sunset for another period if they are happy with the way the company is run*. Unfortunately, no matter how stellar the performance of the company, if a vote were to be held to renew for term the sunset, short-term funds of all stripes resorting to all types of financial tricks, eager to get their hand on

the control premium that will result from the abandonment of the multiple voting class of shares, would flock to the company. (And some traditional investment funds may well join them). Then, it is highly improbable that a majority of the class of (new) shareholders with inferior voting power would agree to a renewal of the dual-class structure for another term[3].

Transferability of Control

As the economic and social benefits derived from family-run companies have been well established, *IGOPP favors a good deal of latitude in the transfer of control to family members*. Any such stipulation should foresee the possibility of an early tragic event occurring before any family member or heir is ready to take over. Under normal circumstances, control may be transferred to heirs and family members with a capacity to play a significant role in the management or governance of the company.

Also consistent with our belief in the role of dual-class of shares as a rampart against short-termism and bullying on the part of some breeds of investors, we believe *that control of such companies may be transmitted to a trust run by a majority of independent fiduciaries for the benefit of family members of the founder.*

Recommendations

We find much merit to dual-class companies and family firms, *provided holders of shares with inferior voting rights are well protected*.

- The mandatory "coattail" provision imposed since 1987 by the Toronto Stock Exchange, a uniquely Canadian feature, must be maintained for any capital structure where different classes of shares have different voting rights. A large component of the putative "private benefits" of control is wiped away by this provision. Perhaps this provision should be included in the regulations of the Canadian Securities Administrators.
- As IGOPP did in 2006, it recommends now that the class of multiple-vote shares going forward **be capped at a ratio of 4:1**, meaning that 20% of the equity is required for absolute control (50% and more) of a company. Although this recommendation of IGOPP (and of the CCGG) has not been heeded, it still retains much value as a principle; it sends a strong message that higher ratios quickly become unacceptable, certainly any ratio exceeding 10:1.

3 A recent Canadian example is very eloquent in this respect. The firm ACT (Alimentation Couche Tard) had adopted years ago a sunset clause to the effect that when the youngest of the 4 controlling shareholders reached the age of 65 the multiple voting shares would revert to single votes. As this deadline loomed, the company, which had posted an extraordinary performance for shareholders over the last 10 years, introduced a proposal to drop this sunset. Their canvassing of large shareholders (and ISS) showed that their proposal would be rejected; so management withdrew it from consideration!

It is also noteworthy that several American studies have shown that beyond a certain point the wedge between the economic interest of the controlling shareholder and his/her voting power impacts the quality of governance, increases the risk of self-serving decisions by the controlling shareholder, and tends to lead to a lower performance for American companies.

But the main argument in favor of superior voting rights remains the ability of the entrepreneur and family to plan and manage for the long term, shielded from unwanted attempts to take over the company. To be insulated against attempted hostile takeovers only requires, in most cases, that the controlling shareholder holds at least 33.3% of the votes.

With a 4:1 ratio, this objective is achieved with 11.1% of the equity!

However, this fact does not appear well understood or sufficiently publicized.

The following table sets out the relationship:

Table C

Ratio of voting rights and controller's equity stake

Ratio of voting rights	% of equity for absolute control (50% and more)	% of equity for blocking (33.3%)
4:1	20%	11.1%
6:1	14.3%	7.7%
10:1	9.09%	4.8%
20:1	4.8%	2.4%

Sources: SEDAR, 2018. IGOPP compilation, 2018.

- **The TSX should cap the multiple vote ratio at 10:1.**
- Class of **shares with no voting rights should be prohibited** as it is difficult to provide rights to elect a third of board members to shareholders without voting rights; or to provide tallies of votes on all shareholder proposals and for the election of board members to a class of shareholders without votes!
- We highly recommend **separate vote tallies for each class of shares**, and that the results be made public, for board election as well as for all other proposals submitted to a vote of shareholders.

- **Shareholders with inferior voting rights should have the right to elect one third of board members**, whose names, however, would have been proposed by the board. Combined with separate vote tallies for each class of shares, this measure would incite management and boards to select nominees who will gain favor with "minority" shareholders. Of course, all board members must act solely in the interest of the corporation.
- For reasons given above and further explained in this paper, IGOPP is **resolutely opposed to the imposition of time-based sunset** on dual-class companies. We also recommend against event-driven sunset clause as well as sunsets triggered by the age of the founder/entrepreneur/controlling shareholder.
- However IGOPP **recommends the adoption of a dilution sunset clause in all future IPOs but one that would be triggered** whenever the controlling shareholder's voting power drops below the level that would maintain a blocking minority (11.1% of the votes with a 4:1 voting ratio).
- Consistent with our belief in the great economic and social value of family-run companies, IGOPP **supports great latitude in the transferability of control to family members**. Any such stipulation should foresee the possibility of an early tragic event occurring before any family member or heir is ready to take over. Under normal circumstances, control may be transferred to heirs with a capacity to play a significant role in the management or governance of the company.
- Also consistent with our belief in the role of dual-class of shares as a rampart against short-termism and bullying on the part of some breeds of investors as well as the evidence marshalled in this policy paper, **we recommend that control of such companies may be transmitted to a trust run by a majority of independent fiduciaries for the benefit of heirs of the founder**[4].
- Whenever kin or descendant of the controlling shareholder is a candidate for the CEO position, independent members of the board, properly advised, should discuss the merits of various candidates with the controlling shareholder **and report fully at the next annual meeting of shareholders on the process by which the board arrived at a decision**.
- We are favorable to the adoption of a version of dual-class of shares **where the superior voting rights are limited to the election of a majority (or all) of the board members**.

The long and careful examination in this policy paper of the case for unequal voting rights and the host of controversial issues surrounding the existence (and growth) of dual-class companies leads us to conclude that the benefits of this structure far outweigh its drawbacks.

4 This position of IGOPP is compatible with a policy option recommended by the Canadian Coalition for Good Governance: permitted transferees include family members and trusts created for the benefit of founder's family members, with a dilution clause triggered if the share ownership of controlling shareholder falls below a stated percentage (CCGG, 2013).

Not only is there growing evidence of their better economic performance but the coupling of dual-class and family ownership brings about longer survivorship, better integration in the social fabric of host societies, less vulnerability to transient shareholders and more resistance to strategic and financial fashions.

This form of ownership precious and useful as it is, must come with safeguards for the minority shareholders and adequate protection of their rights. We have made a number of recommendations to this end. We urge current dual-class companies and entrepreneurs considering going public with this form of capital in the future to adopt our recommendations.

Introduction: The Terms of the Argument

There are now 69 dual-class companies listed on the Toronto Stock Exchange (see Appendix page 57), down from 100 in 2005. Only 23 Canadian companies went public since 2005 with a dual-class of shares while 16 have since converted to a single-class.

In the USA during the same period of time, some 322 companies went public with a dual-class of shares, that model increasing in popularity over the last five years. By 2017, 19% of American IPOs came with a dual-class of shares. (*Council of Institutional Investors*, 2018)

It is not surprising then that the simmering feud between the church of the "one share-one-vote" and the heretic believers in shares with unequal voting rights has boiled over in the last few years, particularly in the USA. The fact that a number of American high-tech entrepreneurs[5] adopted a dual-class of shares may well have provoked the renewed attack on this type of capital structure, particularly when some, like Snap Inc. have chosen to issue shares without voting rights[6].

The issue is caught in a vise between two powerful trends: on the one hand, the increased activism of funds (including the so-called "activist" hedge funds) pushing and shoving boards and management of companies to boost share price and/or sell prematurely the business has reinforced the determination of entrepreneurs to insulate themselves against such pressures by adopting a dual-class of shares at IPO time (more so in the USA than in Canada).

On the other hand, index funds and ETFs, now large and growing «investors»[7] obliged to closely track the market value composition of a particular stock index, cannot manifest their discontent about a corporation by simply selling its shares. They must wield influence on corporate management through their voting power (which is restricted in dual-class companies) and by loudly voicing their frustration and disagreement.

Not surprisingly, these latter investors are ferociously hostile to dual-class of shares and have been strident lately in their opposition, urging, successfully, the index providers (i.e., Dow-Jones, etc.) to exclude from their indices in the future any company with unequal voting rights. They are also lobbying, not yet successfully, the SEC to prohibit this type of capital structure. Their latest gambit, promoted by *The Council of Institutional Investors*, would impose a mandatory time-based sunset clause of seven years. Of course this term could be renewed by a majority vote of all classes of shareholders!

The issue of "sunset clauses" has thus gained salience as institutional shareholders and various agencies try to curtail, rein in, and put a time limit on the relative freedom that a dual-class of shares provides to entrepreneurs and family corporations.

It is perhaps useful to recite the main arguments *for* and *against* dual-class capital structures:

5 A sample of high-tech companies with a dual-class of shares would include Google, Dropbox, Facebook, Groupon, LinkedIn, Square, TripAdvisor, Yelp, Zillow and Zynga.

6 The bitter reaction of investors is understandable. By issuing to the public shares without voting rights, Snap Inc. will not have to hold annual meetings of shareholders, publish annual Management Proxy Circular (which provides information on executive compensation) or list the names of shareholders holding 5% or more of the shares.

7 The three major American managers of ETFs (Vanguard, BlackRock and State Street) in 2017 held 18% of all shares of the S&P 500 companies. (Fichtner, Heemskert et Bernardo Garcia, 2017).

The Arguments Against

The opposition to this type of capital structure usually rests on three arguments. The *first* and, in the mind of opponents, the most compelling argument reproaches the undemocratic nature of different voting rights. One share-one vote becomes the equivalent of the hallowed "one person-one vote" precept of democratic political system (a recent achievement, it should be pointed out).

For all its superficial plausibility, the argument is hollow. The equivalent of "one person-one vote" to the domain of shareholding would be "*one shareholder-one vote*" irrespective of the number of shares a shareholder actually owns. Indeed, in political democracies, citizens do not acquire more voting rights because they pay more taxes to the government.

The analogy of shareholding with citizenship falters in other respects: short-term "tourist" shareholders should not get to vote for the same reason tourists who happen to be in a country on voting day cannot claim voting rights; and then, "new comers" to the shareholding of a company would have to wait for a significant period of time before acquiring "citizenship" and the right to vote as is the case for immigrants, even though employed and paying taxes. Clearly this argument cannot be taken seriously.

Needless to say, proponents of the "one share-one vote" recoil at these obvious logical inconsistencies of the shareholder-citizenship equivalence.

The *second* argument points to the imperviousness of the board and management of a dual-class company to the will, wishes and whims of shareholders. In the days of widely dispersed share ownership, that argument was moot as shareholders had no interest and no means to influence the management of a company.

Nowadays, institutional shareholders, ETFs and pension funds hold sizeable positions in most publicly traded companies. They often assemble in organizations, such as the *Canadian Coalition for Good Governance* or *The Council of Institutional Investors* in the U.S., to leverage their influence on the management of targeted companies. These shareholders want to be heard and listened to. They often lament the fact that their influence is constrained when companies have adopted a dual-class of shares and/or are controlled by a shareholder or related shareholders.

Up to a point, that is a valid argument. But it supposes 1) that shareholders are the only relevant constituency for a publicly listed corporation; though some still parrot that notion, the Supreme court of Canada has on two recent occasions made it clear that all stakeholders must be considered relevant to a board which must act *in the interest of the corporation*; 2) that the desiderata of investment funds, if agreed to, would benefit the long-term interest of the corporation, its shareholders and stakeholders. There is quite a bit of evidence that some funds may well pressure companies to take actions that are not in the best long-term interest of all stakeholders.

This argument also supposes that investment funds will know better than the board of directors and management what actions should be taken. No doubt such cases do occur but they are indicative of a failure of governance. Therefore, the concern should rest with the quality of governance in the controlled companies as well as in the non-controlled companies.

The *third* argument points to the purported lower performance of companies controlled through a dual-class of shares. We shall review, in a further chapter, a number of the studies published since 2007 on that issue but, suffice it to write at this point, that empirical studies do not offer a compelling support for that thesis, indeed, it may tilt the other way.

As always with empirical studies, issues of sample design, statistical analysis, selection of variables and so on always crop up. Studies of this nature rarely provide unassailable evidence *against nor in favor* of dual-class structures.

The following table summarizes the findings of some 37 studies published since 2007 on the relationship between dual-class of shares and performance[8].

Table 1

Empirical studies of the relationship between
dual-class capital structure and company performance, 2007 to 2018

Impact of DCS on performance	**Studies**	
	Number	%
Favorable or neutral	18	49%
Unfavorable	19	51%
Total	**37**	**100%**

Source: IGOPP compilation, 2018.

We wrote in 2006, "*Academia is enlightening but not decisive*"; that remains true, though a crop of recent studies have brought solid empirical evidence on this issue.

For instance, the results of a recent, large-scale study by Cremers *et al*. (2018) are of significant interest. He examined an extensive *matched sample* of U.S. dual and single class firms from the

8 It must be noted that most of these studies are based on American dual-class companies. Almost no dual-class American companies have the equivalent of the Canadian "coattail" provision; the fact that a controlling shareholder cannot sell the control without all other shareholders receiving the same price for their shares eliminates a sizeable source of "private benefits" for the controlling shareholder. This feature, in turn, is likely to have an impact on the relative performance of stock price of dual-class companies in Canada versus in the USA.

time of their IPO. He found some important differences between dual-and single-class firms such as the longer survival and lower takeover activity of dual-class firms.

His results also show *a valuation premium for dual-class of shares* (DCS) over single class firms, which is maintained for 6 to 9 years after their IPO. DCS firms older than 9 years tend to have lower valuations compared to single class structures, perhaps related to the fact the wedge between the economic interest (fraction of shareholder equity held) of the controlling shareholder and his or her voting power (share of total votes held) tends to increase as the firm ages. However, this many years after an IPO, these "findings" must be interpreted with care.

The highly respected scholars Anderson, Ottolenghi and Reeb (2017) established that 9.4 % of a sample of 2,379 firms (drawn from the Russell 3000) had a dual-class of shares and "that these firms were significantly larger, older and better operating performers than their single-class firms in a matched sample". Nearly 90% of dual-class firms are also family firms according to them, the dual-class firms often being a manifestation and continuance of family ownership. Although there are marginal differences between dual-class founder firms, descendant firms, and professionally-managed firms, their analysis indicates that stock returns do not materially differ based on the type of family firm.

This finding of Anderson et al. contradicts a generally accepted bit of wisdom, that once the founding entrepreneur has passed on, dual-class companies tend to achieve marginally better performance when successor family members play an active role in the governance of the company managed by unrelated professionals. (Anderson, 2003; Bebchuk, 2017; Bennedsen, 2007; Villalonga, 2006; Wagner, 2015; Van Essen,2015)

The arguments supporting unequal voting rights

The *first* argument holds that the entrepreneur/founder of a business brings so much value to the company that he/she deserves a greater degree of control than what accrues to a shareholder who merely puts up some money to buy shares. This entrepreneur should be capable of implementing strategies to fully develop his vision of the business without having to worry about takeover threats. That argument is so compelling that it is conceded even by the fiercest opponents of dual-class of shares.

A *second* argument points to the fact that many dual-class companies become family businesses[9], which have a longer life, are better integrated in their communities and more likely to plan and manage with a long-term perspective.

9 Not all family businesses have a dual-class of shares and not dual-class companies are family businesses; but the overlap is considerable. A recent study of 43 canadian family-run publicly listed companies finds that 63% of them had a dual-class of shares (National Bank of Canada, 2018). Similarly, more than half (57%) of the 69 Canadian companies with superior voting rights shares(SVRS) may be considered family firms. That number will likely grow as many of them are controlled by entrepreneurs yet too young to bring in family members. (IGOPP, 2018). According to Anderson et al. (2017) quoted above, nearly 90% of U.S. dual-class firms are also family firms.

Whether a family business or not, companies with a dual-class of shares are relatively immune to the pressures of financial markets for short-term results and stock price boosting manoeuvers.

In an era of exotic funds, of "activist" hedge funds seeking to bully companies into taking actions of short-term consequences, this feature of dual-class of shares becomes very attractive and beneficial for the whole industrial system of a country. It is the ultimate defense mechanism, particularly in Canada where staggered boards do not exist and poison pills are of very short duration.

Thirdly, society at large must not be the pawn of international financial markets. Ownership of key companies and the ability of domestic companies to grow to a large size without threat of unwanted takeover are fundamental tenets of a healthy polity. Most countries adopt some means and measures to achieve this goal. Few subscribe fully to a sort of Schumpeterian "creative destruction" as the best system for a society's stakeholders.

Canada, by law, has protected from foreign takeover whole industrial sectors: banks[10], insurance, media, telecoms, airlines. However, for all other industrial sectors, Canada's regulations of unwanted takeover bids, foreign or domestic, were designed to favor the prospective acquirer.

At particular junctures, if it were not for a substantial number of dual-class companies, Canada would have become the U.S. branch plant of yore. For instance, in the period 2002-2003 when the U.S. dollar was worth close to C$1.60 and the Canadian stock market was seriously depressed, almost all Canadian champions would have been bargains for U.S. acquirers.

It is significant that many of Canada's industrial champions are controlled corporations often through a dual-class of shares. That is the conclusion one may draw from the *Ontario Institute for Competitiveness and Prosperity* study (ICP, 2008) which identified 72 Canadian industrial champions. Some 23 of them were widely-held corporations but 33 were listed and controlled corporations, 19 of them via a dual-class of shares; another 16 were privately held!

Furthermore, 12 of the 50 largest Canadian employers are dual-class companies. (Financial Post, 2018)

Lastly, Canadian dual-class companies have almost all[11] adopted a "coattail" provision (a feature largely absent in the USA), which ensures that all classes of shareholders will receive the same price for their shares, should the controlling shareholders decide to sell out. That twist, by itself, has removed most of the potential "private benefits of control" through a dual-class of shares.

It is also significant that dual-class companies have put in place *high quality governance systems* comparable to that of any single class company[12].

10 In the case of Canadian chartered banks, all attempts at of control, Canadian or foreign, are prohibited.

11 In Canada, of the 69 dual-class corporations in 2018, 61 have adopted a coattail provision and 8 still have not: AGF Management Limited, Andrew Peller Limited, Becker Milk Company Ltd. (The), Corby Spirit and Wine Limited, Power Corporation of Canada, Reitmans (Canada) Limited, Rogers Communications Inc. and TVA Group Inc.

12 Thus, the Board Games 2018 of the Globe and Mail annual governance scoring of TSX listed companies for 2018 reveal that if one eliminates the score for Question 30 (which, without much empirical justification, penalizes by up to 10 points any company with a dual-class of shares), the average governance score of companies without a dual-class of shares is 66.15 while the score of companies with multiple voting shares is 60.1, a barely significant difference (Student's t= 2.18) (Board Games, 2018, IGOPP compilation, 2018).

Back in 2006, after having carefully assessed the pros and cons of dual-class of shares, IGOPP issued a policy paper favorable to this type of capital structure, provided "minority" shareholders were well protected. Therein, IGOPP made six recommendations:

1. A strengthened coattail provision should be part and parcel of any capital structure where different classes of shareholders have different voting rights
2. As a guideline for future entrepreneurs, it is recommended that the class of multiple-vote shares going forward be capped at a ratio of 4:1, meaning that 20% of the equity is required for absolute control (50% +) of a company.
3. Class of shares with no voting rights should be prohibited.
4. A number of independent board members, proposed by the board, should be elected solely by shareholders other than the holders of superior-voting shares. The proportion of board members so elected should never be less than one third of board members.
5. Whenever a kin or descendant of the controlling shareholder is a candidate for the CEO position, independent members of the board, properly advised, would discuss the merits of various candidates with the controlling shareholder and report fully at the next annual meeting of shareholders on the process by which the board arrived at a decision.
6. Given the variety of situations, IGOPP did not favor the inclusion of "sunset clauses" setting a time, or the circumstances, when the class of shares with superior voting rights would be eliminated. However, when no family member of the controlling shareholder is likely to play in the future a significant role in the management or on the board of the company, the controlling shareholder should discuss with the board a process for the appropriate and orderly termination of the dual-class structures.

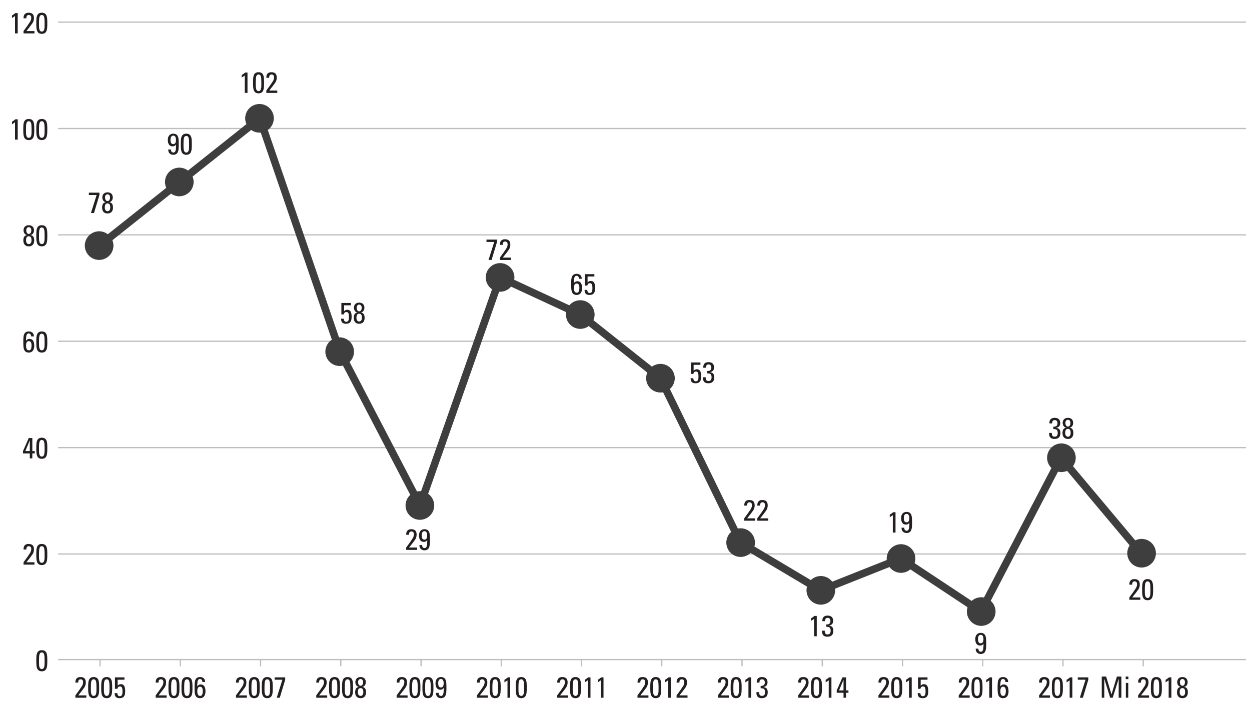
In this policy paper, IGOPP examines pertinent data on the evolution of the dual-class phenomenon since 2006, surveys pertinent research on the topic, evaluates the pros and cons of sunset clauses and, finally, revisits its 2006 recommendations in light of this new evidence.

Dual-Class of Shares in Canada: Evolution Since 2005

For whatever reasons: tenacious criticism of this capital structure by (almost) all champions of « good » governance, including proxy management advisors, the lack of enthusiasm of investment funds, the negative advice of investment bankers or the transiency of new entrepreneurs, the fact is that, in Canada, the number of dual-class companies went from 100 in 2005 to 69 in 2018.

As a percentage of total firms listed on the TSX, dual-class companies dropped from 6.9% to 4.6%. These dual-class companies now account for some 17% of the TSX 60[13]. Of course the number of IPOs in Canada has been in secular decline as figure 1 shows.

Figure 1

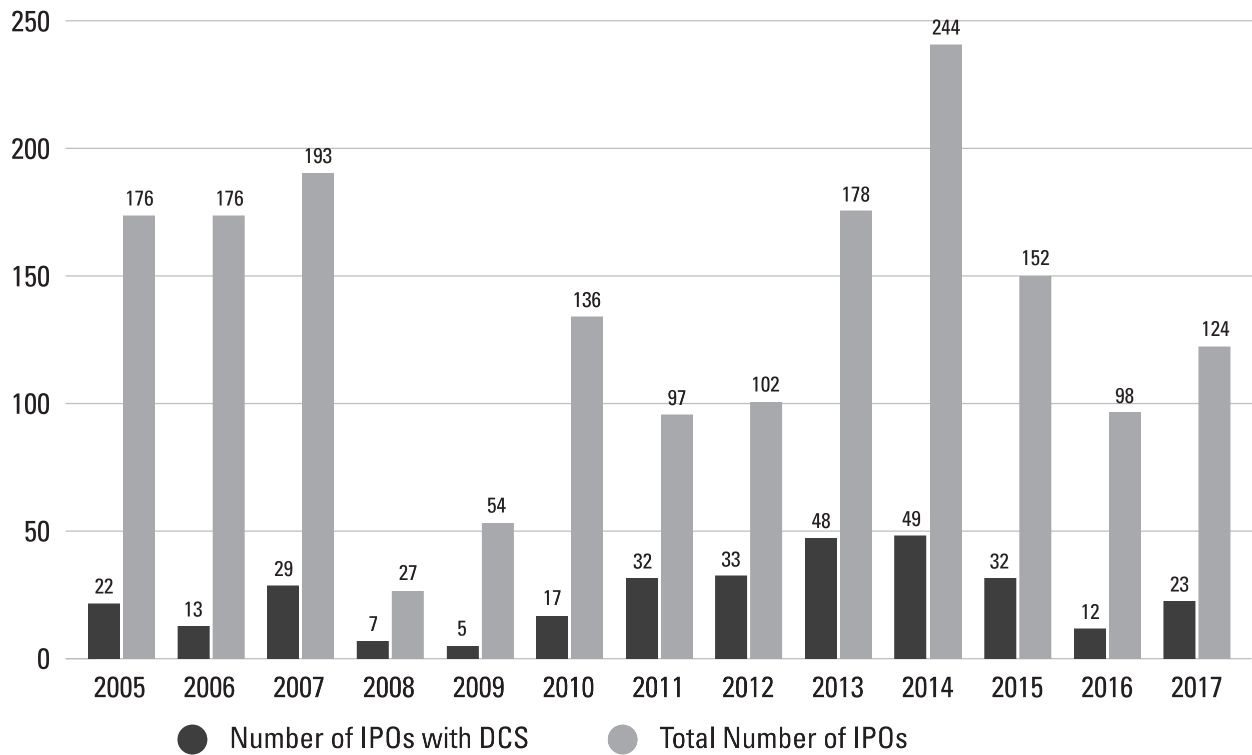


Source: 1. C. Carpentier, C and Suret J-M., Three Decades of IPO Markets in Canada: Evolution, Risk and Return, 2018. 2. Marowits, R., Canadian IPOs rebound in 2017 and set stage for 'blockbuster' 2018, PwC says, The Canadian Press, 2018. 3. PwC, First half IPO market is "slow and steady": PwC Canada survey, 2018.

13 These dual-class companies account for 12% of total market cap of the TSX 60; oddly, the American dual-class companies also represent 12% of total market cap of the S&P 500 companies (IGOPP compilation, 2018).

By contrast the IPO market in the U.S. remains strong with a substantial number of new dual-class companies, as shown in figure 2. Since 2010, dual-class of shares were a feature for 22% of American IPOs.

Figure 2



Sources: Jay R. Ritter, Initial Public Offerings with Multiple-Class share Structures, 2017; Wilmer Hale, 2017 IPO report, 2017. Council of Institutional Investors, Dual-Class IPO Snapshot: 2017–2018 Statistics, 2018. IGOPP compilation, 2018.

Characteristics of Canadian dual-class companies

These 69 dual-class corporations are spread across Canada with more than half headquartered in Ontario, as shown in table 2.

Table 2

Dual-class companies on the TSX by province, 2018

Headquarters	Number	%
Ontario	38	55%
Québec	20	29%
Alberta	4	6%
British Columbia	5	7%
Nova Scotia	2	3%
Total	**69**	**100%**

Source: IGOPP compilation, 2018.

Table 3 shows the large variations of voting rights across these 69 companies. Surprisingly, 19 of them have a class of non-voting shares (1:0).

In what is a relatively new phenomenon, some 11 companies now have two classes of shares, one with the right to elect all (or a majority) of board members, the other with the same voting rights as the first in all other matters. It seems that the fact that the holders of the superior class of shares decide who is elected to the board provides sufficient control.

Table 3

Canadian dual-class companies,
Voting rights, number of firms and %

Superior voting rights	Number of firms	%
1:0	19	27,6%
1:0*	11	15.9%
4:1	3	4.3%
5:1	1	1,5%
6:1	1	1,5%
10:1	20	28.9%
20:1	4	5.8%
25:1	2	2.9%
30:1	1	1,5%
50:0**	1	1,5%
50:1	3	4.3%
50:1	3	4.3%
Total	**69**	**100%**

Notes: *Companies with superior voting rights only for the election of board members;
**The Rogers company, controlled by the Ted Rogers Family Trust, has unusual arrangements: a class of shares without votes and a class of shares with 50 votes per share!

Source: IGOPP compilation, 2018.

In other cases, the ratio of multiple votes ranges from 4:1 to 100:1 with a large concentration at 10:1.

Table 4 identifies the 19 firms with a non-voting class of shares, 10 of which are headquartered in Ontario and one in Quebec.

Table 4

Corporations with non-voting shares by province of residency 2018

	Companies	Province
1	Akita Drilling Ltd.	AB
2	Atco Ltd.	AB
3	Canadian Utilities Limited	AB
4	Shaw Communications Inc.	AB
5	GVIC Communications Corp.	BC
6	Madison Pacific Properties Inc.	BC
7	TriMetals Mining Inc.	BC
8	Empire Company Limited	NS
9	AGF Management Limited	ON
10	Andrew Peller Limited/Andrew Peller Limitee	ON
11	Becker Milk Company Ltd. (The)	ON
12	Canadian Tire Corporation Limited	ON
13	CCL Industries Inc.	ON
14	Corby Spirit and Wine Limited	ON
15	Corus Entertainment Inc.	ON
16	Guardian Capital Group Limited	ON
17	Reitmans (Canada) Limited	ON
18	Urbana Corporation	ON
19	TVA Group Inc.	QC

Sources: SEDAR, 2018; IGOPP compilation, 2018.

Table 5, hereunder, lists the 11 companies with superior voting rights only for the election of board members.

Table 5

Companies with a superior voting class of shares only for the election of board members, 2018

	Corporations	Nature of superior right
1	Alignvest Acquisition II Corporation	Elects 100% of board members
2	Brookfield Asset Management Inc.	Each class elects half of board members
3	Brookfield Real Estate Services Inc.	A class elects 3/5 of board members, the other 2/5
4	Canaccord Genuity Acquisition Corp.	Elects 100% of board members
5	Fiera Capital Corporation	A class elects 2/3 of board members the other 1/3
6	Molson Coors Canada Inc.	A class elects 80% of board members the other 20%
7	ONEX Corporation	A class elects 60% of board members the other 40%
8	Redknee Solutions Inc.	A class elects 4 board members the other 3
9	SmartCentres Real Estate Investment Trust	A class elects 4 board members the other 3
10	Wilmington Capital Management Inc.	A class elects 60% of board members the other 40%
11	Brookfield Renewable Partners L.P.	A class elects 100% of board members

Sources: SEDAR, 2018; IGOPP compilation, 2018.

Mapping the changes in dual-class companies from 2005 to 2018

Significant changes have occurred in the composition of dual-class companies since 2005. Table 6 shows the movement in and out of the group of dual-class companies.

Table 6

Change of status of Canadian corporations with a dual-class of shares from 2005 to 2018

Change of status	Number of corporations
Dual-class companies on the TSX in 2005	100
Dual-class companies in 2005 which changed status since	-54
Newly listed companies with a dual-class of shares between 2005 and 2018	+23
Dual-class corporations on the TSX in 2018	69

Sources: SEDAR, 2018; IGOPP compilation, 2018.

From 2005 to 2018, 54 corporations with superior voting rights shares (SVRS) changed status because of conversion, acquisition, merger or bankruptcy while 23 new corporations were added to the group.

Table 7 lists the reasons for the movement out of the group of dual-class companies.

Table 7

Reason for change of status for 54 companies with a dual-class of shares from 2005 to 2018

Reason for change of status	Number of companies
Acquisition	25
Conversion	16
Merger	7
Bankruptcy	5
Other	1
Total	**54**

Source: IGOPP compilation, 2018.

Since 2005, some 16 corporations changed status because of conversion from a dual-class of shares to a single class, which shows considerable movement in this group of companies.

Of the 16 companies which converted to a single-class structure, the controlling shareholder was financially compensated for this change in six cases; in other cases, no compensation were paid (usually because a coattail provision eliminated the economic benefits of control). Table 8 shows the pertinent data.

Table 8

Dual-class share corporations having converted to a single-class of shares with or without financial compensation from 2005 to 2018

	Companies	Vote Ratio before conversion	Conversion with financial compensation	Conversion without financial compensation
1	BMTC Group Inc.	20:1		✓
2	Caldwell Partners international Inc.	1:0	✓	
3	Canam Manac Group Inc.	5:1	✓	
4	Coolbrands International Inc.	10:1		✓
5	Diaz Resources Ltd.	25:1		✓
6	Extendicare Inc.	10:1		✓
7	International Forest Products Ltd.	10:1		✓
8	Le Château Inc.	10:1		✓
9	Magna International Inc.	300:1	✓	
10	MDC Partners Inc.	20:1		✓
11	Metro Inc.	16:1		✓
12	MI Developments Inc.	500:1	✓	
13	Prometic Life Sciences Inc.	10:1		✓
14	Royal Group Technologies Limited.	20:1	✓	
15	Shawcor Ltd.	10:1	✓	
16	Telus Corporation	1:0		✓

Sources: SEDAR, 2018; IGOPP compilation, 2018.

The 23 new additions since 2005 have adopted varying forms of superior voting rights, as shown in table 9.

Table 9

Voting rights of the 23 new corporations with a dual-class of shares since 2005

Superior voting rights		Number
1:0	Non-voting shares	4
1:0*	A class elects the majority or all board members	6
4:1		1
6:1		1
10:1		6
20:1		1
25:1		1
50:1		2
100:1		1
Total		**23**

Sources: SEDAR, 2018; IGOPP compilation, 2018.

Since 2005, four companies came on the market with a class of non-voting shares, three new dual-class companies adopted voting ratios of 50:1 or more, and a single company adopted a 4:1 voting ratio; clearly the 2006 recommendations of IGOPP have not been heeded!

What should we conclude from this review of events since 2005?

- First, the paucity of IPOs in Canada over the last ten years is striking.
- Then the movement in and out of this group of companies with a dual-class of shares has been considerable in the 12 years since our last survey.
- Of the 23 companies that went the IPO route with a dual-class of shares since 2005, four issued a class of shares without voting power, and five have given the superior voting shares a multiple of 20:1 and more.
- IGOPP's recommendation in 2018 must be blunter and come with a bigger stick!

Empirical Studies of Dual-Class Companies

The issues surrounding listed companies with a capital structure made up of two classes of shares with unequal voting rights have generated a good deal of interest among academics. They have produced a large number of studies, most of them about U.S. companies, though several have an international scope.

Many of these studies have focused on the comparative financial or stock performance of these anomalous companies, including the notorious share price "discount" supposedly imposed on companies with unequal voting rights. Others have investigated ancillary matters such as the relative frequency of "earnings surprises", the comparative level of executive compensation and so forth. As many dual-class companies happen to be family-controlled, many studies mix these two characteristics, often without a clear attribution of effect to one or the other feature.

As we have reviewed empirical studies on this topic in our 2006 policy position, we have limited our survey here to empirical studies published since 2007.

This section is organized around three topics:

1. Studies of financial and stock market performance;
2. Performance of family firms/dual-class companies in the USA;
3. Performance of family firms/dual-class companies in Canada.

1. Studies of comparative financial and stock market performance

Among the 100+ studies of dual-class companies published since 2006, some 37 focused on relative financial and stock market performance. Table 10, which summarizes the results of these 37 studies, reveals their lack of unanimity[14].

14 Summary information about these 37 studies will be found on IGOPP's Web site at https://igopp.org/empirical-studies-on-dual-class-companies-2007-to-2018/

Table 10

Empirical studies of the relationship between dual-class capital structure and company performance, 2007 to 2018

Impact of DCS on performance	**Studies**	
	Number	%
Favorable or neutral	18	49%
Unfavorable	19	51%
Total	**37**	**100%**

Source: IGOPP compilation, 2018.

A. Clearly the diversity of results, indeed their contradictory nature, invites prudence in relying too heavily on one or the other study; the design, sampling choices, variable selection, statistical analysis, and so forth might explain some of the variations in results. Again, it is important to emphasize that most of these studies are American where very few dual-class companies must abide by the "coattail" provision imposed on most Canadian companies; that provision largely removes the "private benefits" of control (as the controlling shareholder cannot sell control without all shareholders being offered the same price for their shares) and thus the "price discount" that, presumably, dual-class companies have to endure.

B. There is a tendency for results of older studies to be less favorable than those of more recent ones; whether that is due to better governance at dual-class companies[15], better protection for minority shareholders or better study design is unclear. Some recent studies deserve consideration because they are particularly well designed. Thus, *Cremers, Lauterbach, Pajuste (2018)*, who studied an extensive *matched sample*[16] of U.S. dual and single class firms from the time of their IPO over the period 1980 to 2015 reach important conclusions:

15 Thus, as already mentioned, the Board Games 2018 of *The Globe and Mail* annual governance scoring of TSX listed companies for 2018 reveal that if one eliminates the score for Question 30 (which, without justification, penalizes by up to 10 points any company with a dual-class of shares), the average governance score of companies *without a dual-class of shares* is 66.15 while the score of companies *with multiple voting shares* is: 60.1, a barely significant difference (Student's t= 2.18) (Board Games 2018, IGOPP compilation, 2018).

16 Matched sample studies have in the past been relatively rare on this topic but they are the best way to understand a complex phenomenon such as the relative performance of two groups of companies different in their capital structure but similar in revenues, market cap and industrial classification.

- dual-class firms have a longer life than single-vote companies. and lower takeover activity;
- the mean wedge (difference between voting power and economic interest of controlling shareholder) increases from 16% one year after the IPO to 22% five years after the IPO, and to 26% after nine years.
- dual-class companies exhibit a *valuation premium* over single class firms, which lasts for 6 to 9 years after their IPO, a result which contradicts the conventional wisdom. Dual-class companies older than 9 years tend to have lower valuations compared to single class structures, though by this time many contaminating factors may have crept in. Though favorable to dual-class companies, this result has Cremer's *et al.* coming out in support of mandatory time-based sunset provision for dual-class structures. However, the authors are well aware that imposing a time-based sunset may lead many entrepreneurs to shun issuing publicly traded shares.

Jordan, Kim, & Liu (2016), based on a matched sample of dual-class and single-class companies, found "*that dual-class firms face lower short-term market pressure (fewer transient or short-term institutional holdings, a lower probability of being taken over, and lower analyst coverage) than propensity-matched single-class firms. Dual-class firms also tend to have more growth opportunities (higher sales growth and R&D intensity).* **The dual-class share structure increases the market valuation of high growth firms, in contrast to the finding in the literature that dual-class firms trade at lower valuations**." (Emphasis added)

The highly respected scholars Anderson, Ottolenghi and Reeb (2017) established that 9.4% of a sample of 2,379 firms (drawn from the Russell 3000) had a dual-class of shares and "*that these firms were significantly larger, older and better operating performers than their single-class firms in a matched sample*".

However, some studies conducted by organizations with an agenda have also purported to demonstrate the inferior performance of "controlled" corporations when compared to "non-controlled" corporations. Thus, in March 2016, the Investor Responsibility Research Center Institute (IRRC) published a study, titled "Controlled Companies in the Standard & Poor's 1500: A Ten Year Performance and Risk Review".

Their overall conclusion, "Controlled Companies Generally Underperform on Metrics That Affect Unaffiliated Shareholders" is squarely and blindingly contradicted by their own results! (See Allaire and Dauphin, April 2016)

Finally, the following table summarizes a number of Canadian articles comparing the stock-market performance of dual-class and single-class companies. However flawed these simple univariate comparisons may be, the sheer number of comparisons giving an edge to dual-class companies make a persuasive point.

Table 11

Comparative annualized based performance of Canadian companies with or without a dual-class of shares

Sources	5 years		10 years		15 years		18 years	
	Dual-class	Single class or index	Dual-class	Single class or index	Dual-class	Single class or index	Dual-class	Single class or index
Bloomberg. "Dual-class share structure boasts some big gainers", The Globe and Mail, April 29, 2016			12.0%	7.1%				
Fournier, P. and A. Katsoras, "The Family Advantage", National Bank of Canada, October 2015*	13.5%	6.1%	11.3%	5.6%				
Ryan Modesto (5i Research), "The case for investing in companies with dual-class shares", The Globe and Mail, April 18, 2016	4.2%	- 0.9%	3.7%	1.1%				
Spizzirri, A., and M. Fullbrook. "The Impact of Family Control on the Share Price Performance of Large Canadian Publicly-Listed Firms (1998-2012)" *Clarkson Center for Board Effectiveness*, June 2013. [voting imbalance firms vs widely-held non family firms]					8.82%	6.60%		
Allaire Y., and F. Dauphin. "Good Governance and Stock Market Performance" *IGOPP*, March 7, 2016.	8.66%	3.78%						
Katsoras et al., "The Family Advantage – The sustainable Outperformance of Canadian Family-Controlled Public Companies", National Bank of Canada, 2018**							9.0%	6.7%

*The 2015 version of the NBC study is based on 30 Canadian family-controlled public companies, and about 2/3 of those 30 firms had a dual-class shares structure.**The 2018 NBC study is based on 43 Canadian family-controlled public companies, and about 27 of those (63 %) had a dual-class shares structure

Source: IGOPP compilation, 2018.

2. Performance of American family firms with (or without) a dual-class of shares

There is a large overlap between dual-class firms and family firms. According to Anderson *et al*. (2017), nearly all existing dual-class structures (93%) arise from entrepreneur and family ownership, among them 89% still have the founding family as part of the ownership.

Dual-class companies "*were significantly larger, older and better operating performers than their single-class firms in a matched sample*".

Investors in family-owned dual-class-companies *earn excess returns on their holdings – about 350 basis points*[17] *per year* versus investors in single class nonfamily firms. Although there are marginal differences between types of family dual-class firms - founder firms, descendant firms, and professionally-managed firms- Anderson *et al*.'s analysis indicate that stock returns do not materially differ between these different types.

Finally, Anderson et al. conclude that dual-class structures do not harm minority shareholders, that 87% of their shares are held by institutional investors and therefore recent calls to eliminate dual-class companies from stock indices are misguided. "*Our analysis indicates that super voting arrangements, in-and-of itself, does not appear to be inconsistent with the goal of shareholder wealth maximization*" (op. cit., p.8).

Van Essen, Carney, Gedajlovic and Heugens (2015) carried out a meta-analysis of 74 empirical studies of US based publicly listed firms and found that, overall, family control has a modest, but statistically significant, positive effect on U.S. listed firm performance (though the authors do not specify if, or how many, firms had a dual-class of shares). Their findings indicate that the family firms *"have the capacity to improve their performance in highly competitive and complex business environments"... "The net positive effect of family control on performance is partially attributable to specific strategic choices made by family firms' managers"*.

3. The performance of Canadian family firms with (or without) a dual-class of shares

Canadian stock-market listed family firms are a sizable component of the Canadian economy, accounting for 10 of Canada's 25 largest employers. (Katsoras, 2018).

In a recent article, Fullbrook (2018) reports historical data on public issuers in Canada from 1969 to 2017 and compares outcomes for family businesses and for non-controlled companies (NC). Canadian family businesses have better long-term survival rates, show more stability in the CEO position and exhibit lower stock price volatility, as compared to non-controlled companies. Nearly 70% of listed family businesses survived through the entire 48-year observation period, while all but 24% of NCs were de-listed, out of business or acquired. If as economist Armen Alchian (1950) suggested, survival is the real test of a firm's success, then Canadian family businesses have passed the test with flying colours.

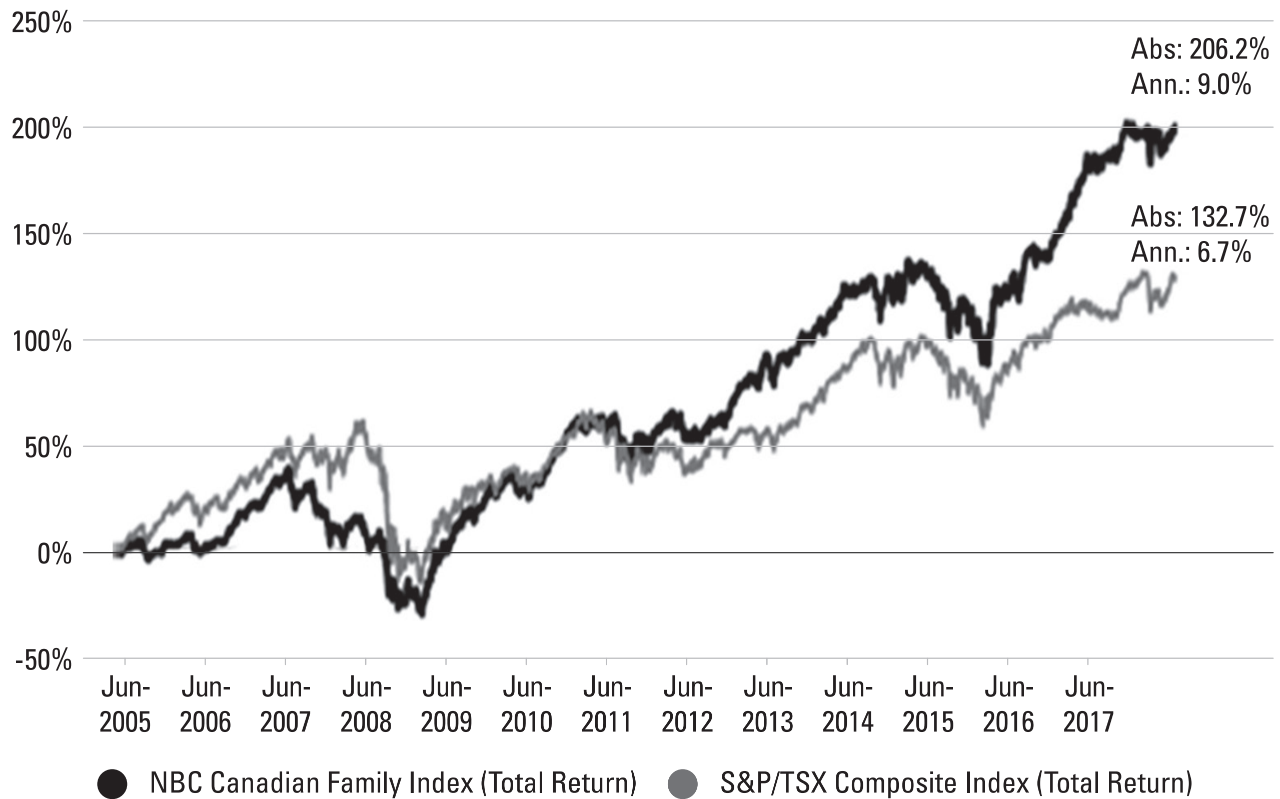
17 Results based on industry, market and Fama-French excess returns (Anderson, 2017).

The National Bank of Canada has created the Canadian Family Index to track the performance of publicly-listed Canadian family-controlled businesses versus the performance of the S&P/TSX composite Index.(Katsoras, 2018)

The NBC index covers 43 Canadian family-controlled firms across different industries and regions of the country, 27 of which had issued superior voting shares. From June 2005 to May 2018, the NBC Canadian Family Index registered an absolute total return of 206% for a compounded annual return of 9%, compared to 133% for the S&P TSX Composite Total Return and a compounded annual return of 6.7%. (See figure 3)

Figure 3

Cumulative performance of the NBC Canadian Family Index from 2005 to 2018



Source: Katsoras, 2018.

Furthermore, Katsoras (2018) explains that the interests of Canadian family owners are in most cases aligned with those of the minority shareholders, even when a dual-class structure is in place. This can in large part be explained by two factors: the coattail provision and the fact that family members have a significant portion of their personal wealth invested in the family business (Katsoras, 2018; Fullbrook, 2018; Sekerci, 2018; Bordonaro, 2017).

Concluding observations

There is no incontrovertible evidence that dual-class companies underperform, in financial or stock market terms, traditional one-share-one-vote companies, actually, *quite the contrary may be more likely according to recent studies*.

The supposed “discount” on the stock price of dual-class companies seems manifest in some studies but at IPO time when a family is in control. For non-family dual-class companies, there is evidence of a “premium”. As most entrepreneurs go public at a time when no other family members are part of management, it would appear that such an entrepreneur evaluating the possibility of an IPO would be well advised to refute the typical investment banker’s “discount” argument to low-ball the issue price.

After the IPO, family controlled dual-class companies appear to outperform by a substantial margin the single-class corporations.

It must be emphasized again that business corporations are not to be judged solely on short-term financial performance, that they are economic and social entities with responsibility to multiple stakeholders and society at large.

For more information, see at https://igopp.org/en/empirical-studies-on-dual-class-companies- 2007-to-2018/ :
Brief review of empirical studies on the economic performance of dual-class companies: 2007 to 2018
Caroline Cambourieu and Mantote Sambiani | IGOPP

Sunset Clauses: What, How and When?

The renewed aggressiveness of some classes of investors against shares with unequal voting rights has re-energized the call for some sort of sunset clause whereby this "privilege" would come to an end at a set point in time.

There are basically tree types of sunset clauses (Bebchuk and Kasiel, 2017, 2018), although the search for new creative alternatives is on-going (fiduciary sunsets, performance sunsets, etc. (Winden, 2017)):

1. Time-based sunsets, whereby the superior voting rights cease after a stated period of time and all shares become equal in voting rights. This particular type of sunset clause has not been adopted by any dual-class corporation in Canada. In the U.S., time-based sunset clauses were rare until recent years, table 12 shows a significant increase in the number of time-base sunset clauses since 1999 with some 15% of companies in Winden's sample carrying such a clause. The typical clause calls for the conversion of superior voting shares generally 7 to 10 years after the IPO.

Table 12

Sunset clauses in a sample of 123 dual-class American companies

	Sunset clauses*						
IPOs (USA)	Time-based		Dilution		Event-driven		**Total**
	YES	NO	YES	NO	YES	NO	**#**
Before 1999	0	44	15	29	2	42	**44**
1999 - 2017	18	61	31	48	35	44	**79**
Total	**18 (15%)**	**105**	**46 (37%)**	**77**	**37 (30%)**	**86**	**123**

*Note that some dual-class companies may have more than one type of sunset clauses.

Sources: Winden, 2017; IGOPP compilation.

2. Dilution sunset refers to the requirement that the controlling shareholder maintain a stated percentage of votes. That clause is found with some regularity in dual-class Canadian companies, though 59% of them carry **no** sunset clauses whatsoever (IGOPP compilation from Anand, 2018).

3. Event-driven sunset usually refers to the death or disability of founder/controlling shareholder or in some cases to the controlling shareholder(s) reaching a specified age. These clauses are rare in Canada[18].Table 12 shows that their popularity has exploded in the U.S. since 1999.

Another feature of dual-class companies has become more salient over the years: *the transferability of control*. To what extent can a controlling shareholder transfer control of the company to heirs, family members, trusts or other parties. It used to be the norm that transfers were unrestricted. However, in 2004, Google's IPO included restrictive covenants on transferability of control, prohibiting "*transfers to family members, or to affiliates, as well as to trusts, IRAs and other legal entities…*". Another iconic tech company, Facebook, did not imitate Google (Alphabet) but maintained the right to transfer control to family members and related entities.

Winden (2017) reports that 75% of dual-class IPOs since 1999 have adopted some form of conditional transferability, though rarely prohibiting transfer of control to family members.

Impact of sunset clauses on stock market performance

Clearly, a good part of Academia, almost all institutional investors and their representatives, index funds, and most "good" governance champions have a stake in getting future dual-class companies to adopt a sunset clause, particularly of the time-based variety.

It would bolster their case if it could be shown conclusively that a company's stock performance is better when a time-based sunset clause has been tacked on to the superior voting rights. Thus far, only one study has tackled empirically this issue. Jackson (2018), cautioning the reader that his study is "preliminary", concludes that seven years after their IPO, the share of companies with a time-based sunset clause show better results than those without such a clause.

We are not informed if, at that point, the entrepreneur/founder is still in charge of the company; we are not informed either about the time left before the sunset takes effect (3, 5, 10 years). Obviously, any sunset clause that would wipe out multiple voting shares in the near future would translate in an anticipation of possible takeover, which, because of the expected control premium, would boost share price. But that's the very reason entrepreneurs choose dual-class of shares: to prevent precipitous takeovers.

We may expect a number of studies of the sort to surface sooner rather than later.

A policy position on sunset clauses and transferability

In the coming years, a battle will rage about sunset clauses, particularly of the time-based sort. An organized effort is already afoot, led by the Council of Institutional Investors, an influential American organization, to oblige future dual-class companies to include a time-based sunset at IPO time[19].

18 Of course, a notable exception is provided by Alimentation Couche Tard where conversion of multiple voting shares is to occur when the youngest of the controlling shareholders reaches the age of 65.

19 The Canadian Coalition for Good Governance (CCGG) takes a more nuanced position than its American counterpart on this issue: "*Because there are many types of DCS companies, it is difficult to have a "one size fits all" definition of MV Share Termination Date"* (CCGG, 2013).

At a minimum, companies considering a dual-class IPO will be urged by investment bankers and sundry influencers to include some time limit on the benefits of superior votes. A movement may well emerge to pressure (or compel) dual-class companies to adopt a time-based sunset long after their IPO.

Clearly, some advocates of sunsets do not accept, or are prepared to forego, the benefits and longevity of dual-class family companies, which are abundantly documented in this policy paper.

They believe that an economic system thrives best on "creative destruction" guided by an "invisible hand", that a company is but a "property" and that stakeholders other than shareholders may, unfortunately but unavoidably, suffer collateral damages. That worldview is injurious to the legitimacy of companies and is increasingly unacceptable to the societies where they are located. In fact, Adam Smith believed "moral sentiments" were essential to the success of capitalism and Schumpeter did not believe this kind of brutal capitalism could survive.

First, about ***dilution sunset*** clauses which are already fairly common in Canada. We recommend that future dual-class companies include such a clause but designed so that it is triggered only when the controlling shareholder's voting power falls below the level required to assure a blocking level of votes (33.3%).

With a 4:1 superior voting ratio, the dilution sunset would be triggered if the entrepreneur controls less than 11.1% of the equity! The following table sets out the relationship[20]:

Table 13

Ratio of voting rights and controller's equity stake

Ratio of voting rights	% of equity for absolute control (50% and more)	% of equity for blocking (33.3%)
4:1	20%	11.1%
6:1	14.3%	7.7%
10:1	9.09%	4.8%
20:1	4.8%	2.4%

Sources: SEDAR, 2018; IGOPP compilation, 2018.

20 The relationship is established thus: (N*x)/[(N*x) + (100-x)]= Target % of votes, where N=ratio of multiple votes, x= the % of equity to achieve Target % of votes sought by the holder of the multiple voting shares. This formula supposes that the controlling shareholder owns all shares with superior voting rights. For instance, with a 4:1 ratio, if 20% of the multiple vote shares were held by the public, the controlling shareholders' voting power would drop to 47% unless they increased their share of the equity from 20% to 24%.

As for ***time-based sunsets***, for all their superficial plausibility, they could actually turn out to be damaging to companies and to the general society. Let's look at three iconic Quebec-based corporations and the consequences if a time-based sunset (say 10 years) had been the norm or the rule in Canada a long time ago.

Table 14

Three iconic Quebec-based corporations according to their market value, number of employees and year of IPO

		Market value		Number of employees	
	Year of IPO	10 years later	Today*	10 years later	Today
CGI	1986	~$2.B	$21.1B	~8000	74 000
ACT (Couche-Tard)	1995	$4.3B	$39.4B	36 000	120 000
Bombardier	1969	~$40M	$5.4B	6 000	60 600

Note: M: Millions of current Canadian dollars B: Billions of current Canadian dollars, *As of November 30th 2018.

Source: IGOPP compilation, 2018.

Had these companies been obliged at IPO time to adopt a time-based sunset, their controlling shareholders might well have decided to remain private companies, forego access to public funds, and limit their growth to whatever alternative funding would sustain. Had they decided to go ahead and include a 10-year sunset clause, these companies would have been taken over a long time ago and turned into some form of branch plant dedicated to the local market[21]!

Some advocates of sunset clauses put forth the optimistic argument that shareholders of both classes may well vote for a renewal of the time-based sunset for another period if they are happy with the way the company is run.

Unfortunately, no matter how stellar the performance of the company, if a vote were to be held to postpone the sunset due date, short-term funds of all stripes resorting to all types of financial maneuvers, would flock into the company's shareholding, eager to get their hand on the control premium that will result from the abandonment of the multiple voting class of shares. (And some

21 For the financially curious, the compounded annual growth in market value for these three companies from ten years after their IPO to nowadays are the following: ACT: 18.6%; CGI 11.3% and Bombardier 13.4% (IGOPP compilation, 2018).

traditional investment funds may well join them). Then, it is highly improbable that a majority of the class of (new) shareholders with inferior voting rights would agree to a renewal of the dual-class structure for another term.

IGOPP is resolutely opposed to the imposition of time-based sunset on dual-class companies[22].

As for ***event-driven sunsets***, it would be practical for controlling shareholders and the board of directors to make arrangement in case some unfortunate event should disrupt the ability of key people to carry on with the leadership of the company[23]. The issue is similar to the challenge of transmission of control to be discussed forthwith.

Transferability of control. Though not strictly speaking a sunset clause, the transferability, with or without conditions, of the controlling shareholder's holding is receiving much attention. Some (few) corporations have adopted clauses that prevent transfer to family members. In general, we observe a great deal of latitude on transferability of control, the only hurdle being the "minimum holding" clause. *Consistent with our belief in the great economic and social value of family-run companies, IGOPP supports great latitude in the transferability of control to family members*. Any such stipulation should foresee the possibility of an early tragic event occurring before any family member or heir is ready to take over. Under normal circumstances, control may be transferred to heirs with a capacity to play a significant role in the management or governance of the company.

Also consistent with our belief in the role of dual-class of shares as a rampart against short-termism and bullying on the part of some breeds of investors as well as the evidence marshalled in this policy paper, *we recommend that control of such companies may be transmittable to a trust run by a majority of independent fiduciaries for the benefit of the founder's family members*. Our position is so in line with the position advocated by the Canadian Coalition for Good Governance (CCGG), 2013.

22 Of course a founder/entrepreneur may well decide, for whatever reasons, to adopt a time-based sunset or an event-driven sunset (at the death or incapacity of founder).

23 Sunsets triggered by the age of the founder/entrepreneur/controlling shareholder should be avoided.

Recommendations: Old, New and Modified

At the end of this lengthy review of dual-class share structures, we revisit the recommendations from our policy paper of 2006 to maintain some, suggest modifications to others and add new recommendations. We find again much merit to dual-class companies and family firms, *provided holders of shares with inferior voting rights are well protected*.

1. The mandatory "coattail" provision imposed since 1987 by the Toronto Stock Exchange, a uniquely Canadian feature, must be maintained for any capital structure where different classes of shares have different voting rights. A large component of the putative "private benefits" of control is wiped away by this provision. Perhaps this provision should be included in the regulations of the Canadian Securities Administrators. It might be advisable for the eight[24] remaining (grand-fathered) companies with a dual-class of shares and no coattail to adopt such a provision.

2. As IGOPP did in 2006, it is recommended that the class of multiple-vote shares going forward be capped at a ratio of 4:1, meaning that 20% of the equity is required for absolute control (50% and more) of a company. Of the 23 companies which have carried out an IPO since 2005 with a dual-class of shares, only one adopted our recommendation! As shown above in table 9, these newcomers still favored a 10-to-1 ratio. Four of them issued non-voting shares and three of them dared issue shares with a 50:1 or 100:1 voting superiority.

Although this recommendation of IGOPP (and of the CCGG) has not been heeded, it still retains much value as a principle; it sends a strong message that higher ratios quickly become unacceptable, certainly any ratio exceeding 10:1.

It is also noteworthy that several American studies have shown that beyond a certain point the wedge between the economic interest of the controlling shareholder and his/her voting power impacts the quality of governance, increases the risk of self-serving decisions by the controlling shareholder, and tends to lead to a lower performance[25]. With a 4:1 voting ratio, the maximum wedge is 30% (voting power of 50% minus economic interest of 20%). At 20:1, the maximum wedge increases to 45.2%!

Finally, and most crucially, it should be stressed that the legitimate desire of entrepreneurs and family companies to be insulated against attempted hostile takeovers only requires, in most cases, that the controlling shareholder holds at least 33.3% of the votes.

With a 4:1 ratio, this objective is achieved with 11.1% of the equity! The following table sets out the relationship[26]:

24 AGF Management, Andrew Peller, Becker Milk Company, Corby Spirit and Wine, Power Corporation of Canada, Reitmans (Canada), Rogers Communications and TVA Group Inc.

25 Cremers, Lauterbach & Pajuste, 2018; Masulis et al. , 2009; Gompers et al., 2009; Baran & Forst, 2015.

26 The relationship is established thus: (N*x)/[(N*x) + (100-x)]= Target % of votes, where N=ratio of multiple votes, x= the % of equity to achieve Target % of votes sought by the holder of the multiple voting shares. This formula supposes that the controlling shareholder owns all shares with superior voting rights. For instance, with a 4:1 ratio, if 20% of the multiple vote shares were held by the public, the controlling shareholders' voting power would drop to 47% unless they increased their share of the equity from 20% to 24%

Table 15

Ratio of voting rights and controller's equity stake

Ratio of voting rights	% of equity for absolute control (50% and more)	% of equity for blocking (33.3%)
4:1	20%	11.1%
6:1	14.3%	7.7%
10:1	9.09%	4.8%
20:1	4.8%	2.4%

Sources: SEDAR 2018; IGOPP compilation, 2018.

Of course, absolute control provides the comfort of choosing the people who will sit on the board (though with 33.3% of the votes, a controlling shareholder could get a large number of candidates of his/her choosing elected). But the main argument in favor of superior voting rights remains the ability of the entrepreneur and family to plan and manage for the long term, shielded from unwanted attempts to take over the company.

However, this fact does not appear well understood or sufficiently publicized.

The TSX should consider capping this ratio at 10:1.

3. Class of shares with no voting rights should be prohibited. Since 2005, four of the 23 new companies with a dual-class of shares have chosen to issue non-voting shares. We state again our objection to this practice. *An effective way to curtail the use of non-voting shares would be to exclude these companies from any stock index*.

However, some dual-class American companies have begun to offer a third (non-voting) class of shares strictly for their employees exercising their stock options or incentivized through shares. Our recommendation does not extend to these situations (unknown thus far in Canada).

4. We recommend separate vote tallies for each class of shares with the results made public for board election as well as for all other proposals submitted to a vote of shareholders.

5. Shareholders with inferior voting rights should have the right to elect one third of board members, whose names, however, would have been proposed by the board. Combined with separate vote tallies for each class of shares, this measure would incite management and boards to select nominees who will gain favour with "minority" shareholders. Of course, all board members must act solely in the interest of the corporation.

6. Given the number of public companies which, in the USA, have recently adopted a dual-class structure, the issue of "sunset clauses" has become salient and controversial. For that reason, we have included in this paper a survey of alternative clauses and their pros and

cons.

When considering this issue in a Canadian context, it is important, first, to note that out of 100 dual-class companies in 2005, no less than 54 changed status over the course of 13 years, 16 of them through a conversion to a single-class of shares. Thus, even in the relative absence of "sunset clauses", there was considerable movement in this category of companies.

Then, we must evaluate the effectiveness of the various types of sunset clauses. There are basically three models of clauses, each one with a different motive and result:

- A temporal sunset clause. Set at IPO time, calls for the conversion of multiple-vote shares after a number of years. Clearly, this clause supposes that, at IPO time, it can be established when in 5, 7, 10, 12 or 15 years, the benefits to shareholders derived from the founder/entrepreneur's control will have been fully realized. Supposing that a 10-year sunset clause had been adopted as the standard years ago, Bombardier would have become a single-class company vulnerable to a takeover in 1979 (!) long before it had become the multinational company it is today; CGI would have been open to takeover in 1996; Alimentation Couche-Tard in 2005 and so on. That would have ensured that these companies would never have realized their full potential. *IGOPP is resolutely opposed to the imposition of time-based sunset on dual-class companies at the time of the IPO*.
- An event-driven sunset clause. At IPO time, some events are identified (i.e. the death or incapacity of the entrepreneur, the age of the founder [s], etc.), which event will trigger a conversion of the multiple-voting shares. Again, this sort of clause supposes a good deal of (rare) foresight about the situation and leadership of the company at that time. For instance, a dual-class structure, meant to give to the leadership of the company the time to implement its vision and strategy, could unravel if the entrepreneur were to die, say, two years after the IPO, although capable successors could carry on with the original plan. *We recommend against event-driven sunset clause as well as sunsets triggered by the age of the founder/entrepreneur/controlling shareholder*.
- A dilution (or minimum shareholding) clause. This sort of clause aims at imposing a minimum level of shareholding on controlling shareholders. Should their holding fall below that minimum, their shares would lose their multiple-voting propriety. Clearly, that clause seeks to ensure that a controlling shareholder may not sell a good part of his/her holding, yet retain control of the company. This sunset clause is the only one that appears with some frequency in Canadian dual-class companies. *IGOPP recommends that a dilution sunset clause be included in future IPOs but one that would be triggered whenever the controlling shareholder's participation drops below the level that would assure him or her a blocking minority (11.1% in 4:1 ratio, see table above)*.
- Transferability of control. Though not strictly speaking a sunset clause, the transferability, with or without conditions, of the controlling shareholder's holding is receiving much attention. Some (few) corporations have adopted clauses that prevent transfer to family members. In general, we observe a great deal of latitude

on transferability of control, the only hurdle being the "minimum holding" clause. *Consistent with our belief in the great economic and social value of family-run companies, IGOPP supports great latitude in the transferability of control to family members*. Any such stipulation should foresee the possibility of an early tragic event occurring before any family member or heir is ready to take over. Under normal circumstances, control may be transferred to heirs with a capacity to play a significant role in the management or governance of the company.

Also consistent with our belief in the role of dual-class of shares as a rampart against short-termism and bullying on the part of some breeds of investors as well as the evidence marshalled in this policy paper, *we recommend that control of such companies may be transmitted to a trust run by a majority of independent fiduciaries for the benefit of the founder's family members*.

This position of IGOPP is compatible with a policy option recommended by the Canadian Coalition for Good Governance (2013): *permitted transferees include family members and trusts created for the benefit of founder's family members, with a* ***dilution clause*** *triggered if the share ownership of controlling shareholder falls below a stated percentage.*

7. Whenever a kin or descendant of the controlling shareholder is a candidate for the CEO position, independent members of the board, properly advised, should discuss the merits of various candidates with the controlling shareholder and report fully at the next annual meeting of shareholders on the process by which the board arrived at a decision.

The annals of business contain numerous examples of highly successful companies which were managed by successive generations of leaders drawn from the same family. The German Mittlestand comes to mind but so do the records of family firms in Canada and the USA, as we reported above.

8. We are favorable to the adoption of a dual-class of shares where the superior voting rights are limited to the election of a majority (or all) of the board members. This sort of arrangement is increasingly frequent in the USA where unwanted attempts at takeover may be rebuffed by the board, which generally has the authority to "just say no".

In Canada, this arrangement would not block a takeover but give rise to delicate situations if the acquirer does not buy all the outstanding shares and remove the company from the stock exchange[27].

In the future, the terms and conditions of dual-class structures will need to be set in a way that meets the goals of the entrepreneur/founder as well as the legitimate expectations of shareholders.

27 Indeed, the acquirer could secure more than two thirds of the votes without the holders of the superior voting shares having handed in their shares. Then the board which has been elected in the majority (or all of them) by shareholders with superior voting rights and which may well have opposed the transaction, is still the acting board. This board could create hurdles for the acquirer. It is not clear that the "squeeze-out" provision would apply to this different class of shareholders. On the other side, it is not clear either that these types of dual-class companies have to adopt a "coattail" provision. Therefore, could the holders of superior voting shares sell their shares and the power to elect most (or) all of the board members without any offer to buy the other class of shares?

Conclusions

This long and careful examination of the case for unequal voting rights and the host of controversial issues surrounding the existence (and growth) of dual-class companies leads us to conclude that the benefits of this structure far outweigh its drawbacks.

Not only is there growing evidence of their better economic performance but the coupling of dual-class and family ownership brings about longer survivorship, better integration in the social fabric of host societies, less vulnerability to transient shareholders and more resistance to strategic and financial fashions.

This precious form of ownership must come with appropriate measure to ensure and protect the rights of minority shareholders. We have made a number of recommendations to this end. We urge current dual-class companies and entrepreneurs considering going public with this form of capital in the future to adopt our recommendations.

Appendix

Canadian dual-class companies traded on the TSX, 2018

1	ADF Group Inc.	36	Fairfax India Holdings Corporation
2	AGF Management Limited	37	Fiera Capital Corporation
3	Akita Drilling Ltd.	38	FirstService Corporation
4	Alignvest Acquisition II Corporation	39	Freshii Inc.
5	Alimentation Couche-Tard Inc.	40	GDI Integrated Facility Services Inc.
6	Andrew Peller Limited/Andrew Peller Limitee	41	Guardian Capital Group Limited
7	Aritzia Inc.	42	GVIC Communications Corp.
8	Atco Ltd.	43	Hammond Manufacturing Company Limited
9	Becker Milk Company Ltd. (The)	44	Hammond Power Solutions Inc.
10	Bombardier Inc.	45	INSCAPE Corporation
11	Brampton Brick Limited	46	Jean Coutu Group (PJC) Inc. (The)
12	Brookfield Asset Management Inc.	47	Lassonde Industries Inc.
13	Brookfield Real Estate Services Inc.	48	Logistec Corporation
14	Brookfield Renewable Partners L.P.	49	Madison Pacific Properties Inc.
15	BRP Inc.	50	Molson Coors Canada Inc.
16	Canaccord Genuity Acquisition Corp.	51	Newfoundland Capital Corporation Limited
17	Canada Goose Holdings Inc.	52	ONEX Corporation
18	Canadian Tire Corporation Limited	53	Power Corporation Of Canada
19	Canadian Utilities Limited	54	Quebecor Inc.
20	Cara Operations Limited	55	Redknee Solutions Inc.
21	CCL Industries Inc.	56	Reitmans (Canada) Limited
22	Celestica Inc.	57	Rogers Communications Inc.
23	CGI Group Inc.	58	Shaw Communications Inc.
24	Cogeco Communications Inc.	59	Shopify Inc.
25	Cogeco Inc.	60	SmartCentres Real Estate Investment Trust
26	Colliers International Group Inc.	61	Spin Master Corp.
27	Corby Spirit and Wine Limited	62	Stingray Digital Group Inc.
28	Corus Entertainment Inc.	63	Teck Resources Limited
29	Dorel Industries Inc.	64	Transcontinental Inc.
30	DREAM Unlimited Corp.	65	TriMetals Mining Inc.
31	Dundee Corporation	66	TVA Group Inc.
32	Empire Company Limited	67	Urbana Corporation
33	EXFO Inc.	68	Velan Inc.
34	Fairfax Africa Holdings Corporation	69	Wilmington Capital Management Inc.
35	Fairfax Financial Holdings Limited		

Source: TMX Data, April 5th, 2018. IGOPP Compilation, 2018.

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About IGOPP

Created in 2005 by two academic institutions (HEC Montréal and Concordia University – The John Molson School of Business), the Stephen Jarislowsky Foundation and the Autorité des marchés financiers, the Institute for governance (IGOPP) has become a centre for excellence about governance of public and private organizations. Through research, training programs, policy papers and participation in public debates, IGOPP has become a key reference on all issues of governance in the private and public sectors.

OUR MISSION

- Strengthen fiduciary governance in the public and private sectors;
- Make organizations evolve from a fiduciary mode of governance to a *value creating governance®;*
- Contribute to debates, and the solution, of governance problems by taking positions on important issues and by a wide dissemination of information and knowledge about governance.

OUR ACTIVITIES

The Institute carries out activities in four particular areas:

- *Policy papers*
- *Research and publications*
- *Seminars on value-creating governance®*
- *Board evaluation and governance interventions*

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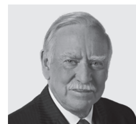

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