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Dual-class shares are hot in the U.S. again : Canada should join in

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American fund managers are freaking out about the popularity of multiple voting shares among entrepreneurs going for an initial public offering (IPO). In recent years, some 20 per cent of American IPOs (and up to a third among tech entrepreneurs) have adopted a dual-class structure. Fund managers are working overtime to squelch this trend.

In Canada, this form of capital structure has been the subject of unrelenting attacks by some fund managers, proxy-advisory firms and, to a surprising degree, by academics. Some 69 dual-class companies are now listed on the Toronto Stock Exchange, down from 100 in 2005. Since 2005, only 23 Canadian companies went public with dual-class shares and 16 have since converted to a single-class.

A dual class of shares provides some measure of protection from unwanted takeovers as well as from the bullying that has become a feature of current financial markets. (The benefits of homegrown champions, controlled by citizens of the country and headquartered in that country need no elaboration. Not even the U.S. tolerates a free-for-all takeover regime, but Canada does!)

These 69 dual-class companies have provided 19 of Canada's industrial champions as well as 12 of the 50 largest Canadian employers. The 54 companies (out of the 69 that were listed on the TSX 10 years ago) provided investors with a mean annual compounded return of 8.98 per cent (median 9.62 per cent) as compared to 5.06 per cent for the S&P/TSX Index and 6.0 per cent for the TSX 60 index (as per calculations by the Institute for Governance of Private and Public Organizations).

As for the quality of their governance, by the standards set by The Globe and Mail for its annual governance scoring of TSX-listed companies, the average governance score of companies *without* a dual-class of shares is **66.15** while the score of companies *with multiple voting shares*, once the penalty (up to 10 points) imposed on dual-class companies is removed, is **60.1**, a barely significant difference.

The opposition to dual-class of shares usually rests on three arguments.

Multiple voting shares are undemocratic.

One share/one vote becomes the equivalent of the hallowed "one person/one vote" precept of democratic political system (a relatively 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, "newcomers" 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 those employed and paying taxes. Clearly this argument cannot be taken seriously.

They make management and boards relatively impervious to the will, wishes and whims of shareholders.

Nowadays, institutional shareholders, ETFs and pension funds hold sizeable positions in most publicly traded 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 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 by a board of directors acting *in the interest of the corporation*.

Dual-class companies do not perform as well for shareholders as single-class companies.

Empirical studies do not offer a compelling support for that thesis; indeed, it may tilt the other way as numerous comparisons have demonstrated.

For instance, the results of recent, large-scale American studies point to the longer survival and lower takeover activity of dual-class firms, a valuation premium for dual-class shares over single-class firms, which is maintained for six to nine years after an IPO, and the finding that dual-class companies are better operating performers than their single-class firms in a matched sample.

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.

Of course, this form of control must come with appropriate measures to ensure and protect the rights of minority shareholders. Most Canadian dual-class companies are well aware of that requirement and have put in place state-of-the-art governance.