Institute for governance
of private and public organizations

The performance of Canadian controlled companies listed on the S&P/TSX:

the positive effects of a long-term vision on environmental and social considerations and on shareholder return

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by

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Legal Deposit - October 2023

National Library of Quebec 2023

ISBN 978-2-924055-59-5 (English version – digital)

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Design by Karine Bellerive

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Acknowledgments

I would like to express my heartfelt appreciation to the members of IGOPP's Board of Directors for their comments, which enhanced the interpretation and the scope of this study's conclusions. Warm thanks as well to Professor Yvan Allaire for his invaluable contribution to the conversation and for his always useful and incredibly relevant comments. Lastly, I would like to thank Alarik Drouart-Lopez, research project manager at IGOPP, as well as all those who took part in collecting individual data—a long and arduous task, to say the least, but necessary to conducting this study.

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Executive summary

Family-run businesses are the cornerstone of market economies. These companies are often imbued with a strong culture rooted in the values of their founder, a culture that develops and strengthens over time, sometimes even beyond the first generations who succeed one another at the helm of the business. They tend to make decisions with a long-term horizon, in consideration of all their stakeholders and the environment, as it is natural for them to want to ensure that future conditions remain favourable. This is the very essence of sustainable value creation.

As they grew, the largest of these companies eventually had to go public. Their founder-entrepreneurs were concerned with maintaining control over the company's operations in order to further a culture that reflects the values central to the company's past successes. As such, they sought to preserve the unique character of their business and ensure they could continue to uphold their long-term vision despite the presence of new shareholders, most of them anonymous and changing.

Given their own imperatives at the time of their company's IPO, some founder-entrepreneurs were unable to raise the necessary funds without diluting their equity stake below the level required to retain control, or did not wish this risk to materialize. They therefore resorted to mechanisms to ensure that control was maintained, notably through the use of different share classes (DCS), each conferring specific rights (multiple voting rights for one of the classes, for example, or exclusive rights to appoint members to the board in order to maintain a majority).

Whether control is exercised through a direct stake or by resorting to a DCS structure, these companies are frequently targeted by categories of investors who consider their governance to be deficient, at least according to the guidelines established for companies with widely held ownership (i.e. without a controlling shareholder). This criticism is often even sharper where DCS companies are concerned, due to the control exercised without an economic stake that is commensurate with exclusive nomination rights or the percentage of votes cast. A number of pressure groups are strongly advocating that all forms of DCS structure be eliminated.

Is this criticism warranted? Does the long-term economic, social and environmental performance of Canadian controlled listed companies support this perception of "bad governance?"

These topics are fiercely debated in various governance forums and have been the focus of considerable research in academic circles. While some voices are raised against founding shareholders and their families maintaining control, others are increasingly being heard in favour of allowing new generations of entrepreneurs to use DCS structures. Several countries have recently revised their rules to allow them on their main stock exchanges, and others, such as France and Germany, are seriously considering doing so in the near future.

The aim of our study is first to situate the debate and summarize the findings of the most recent research. We then compare the performance of Canadian controlled companies in the S&P/TSX Index with that of Canadian companies with widely held ownership in the same group. Comparisons are based both on ESG ratings (Environmental, Social and Governance performance) and total shareholder return over five and 10 years.

In general, the in-depth review of recent studies confirms:

- a **favourable effect in maintaining control over companies' capacity for innovation** and **better quality of financial information** (including the predictive utility of data) disclosed by controlled companies;
- **greater longevity of controlled companies** compared to their one-share-one-vote counterparts;
- a **more pronounced commitment to social and environmental criteria by family-controlled firms**, and that this commitment was observable long before "responsible" investing became an essential concern, and therefore long before "ESG" made its way into the everyday lexicon;
- there is **no conclusive support for the hypothesis that DCS structures are detrimental to corporate value**;
- Canadian controlled companies, including those with a DCS structure, show higher long-term total shareholder returns than their widely held counterparts;
- **the shares of controlled companies tend to be less volatile** and therefore present a lower level of risk for investors;
- given the evidence of better financial results for companies with DCS, the debate has increasingly moved toward imposing sunset clauses aimed at restricting the maintenance of control to a predetermined time horizon. In this respect, discussions are more theoretical in nature, with little empirical support. Nevertheless, it is clear from the arguments that the desire to maintain control rests first and foremost on the ability to endow and execute a long-term vision for the organization, and that imposing a time limit—especially a short one—runs counter to this de facto primary quality.

Our own comparative study also yielded a number of findings:

- In terms of share performance, our results support those of the studies reviewed, demonstrating that **Canadian controlled S&P/TSX companies outperform their uncontrolled counterparts in terms of long-term total shareholder return**;
- After comparing samples of companies matched using the industry classification system, **Canadian controlled S&P/TSX companies have a better unmanaged ESG risk index than their uncontrolled peers**, despite the fact that the index is biased against controlled companies;
- For more than a decade, and especially in the 2021 reference year, **Canadian controlled S&P/TSX companies have had a higher environmental "E" score than uncontrolled companies**;
- At no time in the past 10 years has it been possible to claim that non-controlled companies are superior to controlled companies in terms of social performance based on the "S" rating;

- Unsurprisingly, since being controlled (particularly through a DCS structure) has a negative effect on the "G" component of the various ratings, controlled companies are assessed—according to the catechism of governance rating agencies—as being less well governed than their widely held counterparts. The net effect of the "G" rating on the combined ESG ratings skews the total results and paints an unfavourable and unfair picture of controlled companies.

The exhaustive review of recent empirical studies and the results of our analysis in a Canadian context speak for themselves: they do not support the ambitions of the categories of investors campaigning for the elimination of DCS structures, nor their quasi-dogmatic approach to the question. On the contrary, the findings should reassure investors and stakeholders in controlled companies.

Despite all the advantages, many of these controlled companies are considered to be poorly governed according to their scores, and maintaining control through a DCS mechanism—considered as a flaw—is also reflected in their overall ESG score. Yet it would be fair to correlate governance quality with long-term shareholder performance and good performance with stakeholders (E and S components), which is not observed with current ratings.

It is extremely difficult to measure the quality of a company's corporate governance using a rating obtained from a standardized grid. To assess it properly, one would need to be able to capture all the subtleties of a group's dynamics, the inherent competence of each board member, the collective intelligence and wisdom of the directors, their shared understanding of the business model, their ability to act with courage at the right time, and so on. Rating agencies have developed standards of "good governance" that can be measured simply, parameters established over the years as being factors that *can contribute to better governance*, but which *are no substitute for governance itself*.

We believe it is important to separate the "G" factor from social and environmental factors when assessing the performance of controlled companies. Governance must be assessed according to the specific characteristics of each of these companies; there may be as many models of good governance as there are companies, but each must adopt governance that is suited to it and that will demonstrate its effectiveness and ability to create long-term value. Total shareholder return over the long term, as well as social and environmental performance, are the *consequences* of the effectiveness of the governance model in place.

The importance of family-controlled companies to the Canadian economy is undeniable. The fact that they have a longer lifespan and a significant impact on all stakeholders, that they show concern for environmental issues, and that they invest with a time horizon that sometimes extends beyond several generations, is an additional quality that should encourage governments and other regulatory authorities to ensure that this model is preserved and encouraged.

We must not allow ourselves to be distracted by the rhetoric of third parties who wish to impose a deadline on a vision and a time limit on the values that have enabled companies to become fully rooted in their communities.

Table of content

Executive summary 5

Introduction 11

What recent studies say on this subject 14

Profile of S&P/TSX controlled companies 22

Canadian controlled companies and ESG factors 25

Performance of Canadian controlled companies 34

Relationship between controlled-company returns and governance score in a Canadian context 37

Findings, discussion and conclusion 38

References and data sources 42

About IGOPP 47

Introduction

Family-run businesses are the cornerstone of market economies. They are often imbued with a strong culture rooted in the values of their founder, a culture that develops and strengthens over time, sometimes even beyond the first generations that succeed one another at the helm of the company.

As a result, these companies tend to make decisions with a long-term horizon, in consideration of all their stakeholders and the environment, as it is natural for them to want to ensure that future conditions will remain favourable. This is the very essence of sustainable value creation.

In Canada, estimates show that family businesses support nearly seven million jobs, or around 47% of the private-sector workforce, and account for around 49% of real GDP.[1]

According to a study by the Creaghan McConnell Group, the largest of these firms pay salaries well above the Canadian average and provide more generous benefits (notably when it comes to vacations and pensions). Many are consistently among the best corporate citizens in Canada and rank highly on criteria such as environmental performance, innovation and safety. Large family-controlled companies are also giving billions annually in charitable donations, and many families have also set up foundations that rank among the leading philanthropic organizations in Canada.

As they grew, the largest of these companies eventually had to go public. Their founder-entrepreneurs were concerned with maintaining control over the company's operations in order to further a culture that reflects the values central to the company's past successes. As such, they sought to preserve the unique character of their business and ensure they could continue to uphold their long-term vision despite the presence of new shareholders, most of them anonymous and changing.

Given their own imperatives at the time of their company's IPO, some founder-entrepreneurs were unable to raise the necessary funds without diluting their equity stake below the level required to retain control, or did not wish this risk to materialize. They therefore resorted to mechanisms to ensure that control was maintained, notably through the use of different share classes, each conferring specific rights (multiple voting rights for one of the classes, for example, or exclusive rights to appoint members to the board in order to maintain a majority). These dual-class share (DCS) structures have enjoyed some popularity, and many Canadian companies have adopted them.

Whether control is exercised through a direct stake or by resorting to a DCS structure, these companies are frequently targeted by categories of investors who consider their governance to be deficient, at least according to the guidelines established for companies with widely held ownership (i.e. without a controlling shareholder). This criticism is often even sharper where DCS companies are concerned, due to the control exercised without an economic stake that is commensurate with exclusive nomination rights or the percentage of votes cast.

1 Data sourced from Forbes & Bassett, *Conference Board of Canada*, September 2019.

Is this criticism warranted? Does the long-term economic, social and environmental performance of Canadian controlled public companies support this perception of "bad governance?"

These topics, fiercely debated in various governance forums, have also been the focus of considerable research in academic circles.

The aim of our study is first to situate the debate and summarize the findings of the most recent research. We then compare the performance of Canadian controlled companies in the S&P/TSX index with that of Canadian companies with widely held share ownership in the same group. To do so, comparisons will be based both on ESG ratings (Environmental, Social and Governance performance) and total shareholder return over five and ten years. Lastly, we will identify the main findings and formulate our thoughts and recommendations.

INSTITUTIONAL INVESTORS DISLIKE DUAL-CLASS SHARES

In June 2022, institutional investors with more than $1 trillion in assets under management came together to found the Investor Coalition for Equal Votes, an organization whose mandate is to dialogue with market stakeholders and regulators to force any company intending to go public with a DCS-type capital structure to adopt a strict time-based sunset clause.[2] The group, whose members include the Minnesota State Board of Investment, the New York City Comptroller's Office, the New York State Common Retirement Fund, the Ohio Public Employees Retirement System and the Washington State Investment Board, represents nearly 5.5 million members and claims to speak on their behalf.

The new coalition was announced by the Council of Institutional Investors (CII), and thus relies on the CII's position on dual-class shares as the basis for its argument.

According to the CII, "'One share, one vote' is a bedrock principle of good corporate governance.[3] When a company taps the capital markets to raise money from public investors, those investors should have a right to vote in proportion to the size of their holdings. A single class of common stock with equal voting rights also ensures that the board of directors is accountable to all of the shareholders."[4]

This principle cited by the CII is also echoed by the leading proxy advisory firms, including Institutional Shareholder Services (ISS), Glass-Lewis and Egan-Jones. In its guidelines for voting recommendations, Glass-Lewis is particularly clear: "No small group of shareholders, family or otherwise, should have voting rights different from those of other shareholders. [...] That power should not be concentrated in the hands of a few for reasons other than economic stake. We generally consider a multi-class structure to reflect negatively on a company's overall governance."[5]

These positions translate into unfavourable votes (or abstentions) against directors, in particular, members of the governance committees of targeted companies.

2 Clause stipulating a date on which multiple voting shares will be converted into single voting shares.

3 For a full discussion of the underlying argument and counter-arguments, see Allaire (2019) in The Case for Dual-Class of Shares.

4 Council of Institutional Investors. Dual class stock, https://www.cii.org/dualclass_stock

5 Glass Lewis 2022 Policy Guidelines. www.glasslewis.com

AN INTEREST IN SHAREHOLDING STRUCTURES THAT FAVOUR MAINTAINING CONTROL

Easier access to private capital, combined with the risk of pressure from activist investors or of falling prey to a hostile takeover bid, means that many founder-entrepreneurs, especially in the technology sector, fear an IPO that would cause them to lose control of their company. To ensure they are able to realize their vision, they seek to maintain a degree of control over research and development activities, at a rate of growth that will guarantee the company's long-term success.

While, as pointed out in the previous section, shareholding structures that favour the maintenance of control beyond actual economic interest are coming under criticism and attack in North America, several jurisdictions are instead seeking to introduce them in order to facilitate access to capital by these new companies. With the number of new IPOs steadily declining on several major exchanges, new ways had to be found to promote this form of access to capital.

Following Singapore and Hong Kong's introduction of DCS structures in 2018, the UK followed suit in 2021, and Germany and France are now considering their introduction in the near future.

In France, the Haut Comité Juridique de la Place Financière de Paris published a report on multiple voting rights in September 2022, proposing an amendment to Article 228-11 of the Code de commerce to lift the ban on listed companies using a structure that includes shares with multiple voting rights.

In Germany, the federal Ministry of Finance published a document in June 2022 outlining the main changes to come in a bid to modernize the country's capital markets. In the document, the government announces its intention to allow DCS structures, particularly for start-up and growth companies. DCS structures have been prohibited under German law since 1998.

While the French and German approaches remain under review, the UK has chosen to authorize dual-class share structures, albeit with certain constraints. Among other things, companies opting for such a structure must include a five-year sunset clause from the IPO date, and the superior share class must confer a maximum of 20 voting rights (20:1 ratio). These conditions severely limit the scope and duration of control conferred by dual-class share structure and make generational transferability of control impossible.

What recent studies say on this subject

IGOPP, which has twice taken a formal position on the subject of DCS structures, noted in 2006 that "Academia is enlightening but not decisive" (Allaire, 2006). Thirteen years later, after analyzing all empirical studies of the relationship between DCS structure and company performance from 2007 to 2018, Allaire (2019) found that 49% of studies were favourable or neutral with respect to DCS structures, while 51% were unfavourable. Careful observation of the differences between jurisdictions and the specific features of each of these studies led the author to the following conclusion: "[t]here 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, which tend to show superior performances achieved by dual-class companies."

Are these observations still valid five years later, in 2023? To find out, we conducted an exhaustive review of scholarly publications dealing with various aspects of DCS structures, but also at the level of family companies controlled by a direct interest (some studies focusing on controlled companies, regardless of the mechanism conferring this control). This update focused on publications or studies released between 2019 and August 2023.

In order to broaden the search to include the social and environmental performance of controlled companies, the publications selected on these characteristics sometimes include periods prior to 2019, in order to obtain a more comprehensive picture of empirical findings on these more targeted topics.

Control as a driver of innovation

Using a risk-adjusted approach and considering market reactions to the introduction of new rules, Lel & al. (2022) find that investors view DCS in research-intensive companies positively. Their view is that over the long term, prohibiting DCS leads to lower R&D spending and fewer patents, lower company value and profitability. Their results suggest that DCS increase valuations and facilitate innovation.

Other researchers have found a significant innovation effect of DCS control in high-tech sectors and hard-to-innovate industries[6] (Cao et al., 2020).

Baran & al. (2023) found a positive association between control by a DCS structure and patent output, quality, creativity, R&D efficiency and innovative risk-taking by senior management. These positive effects are particularly evident in financially constrained companies and those in highly competitive sectors. According to their results, however, these favourable effects dissipate within 10 years after the initial public offering.

6 According to Cao et al. (2020), these industries face greater difficulties in their innovation activities due to the long time and high monetary cost required to convert R&D expenditure into patents. The authors include pharmaceuticals, medical devices, chemicals, computers, communications and electrical industries in this group.

Overall, therefore, recent research tends to confirm that maintaining control has a favourable effect on the innovation capacity of listed firms.

The quality of financial disclosure

Observing the quality of financial information disclosed by American listed firms between 2012 and 2017, Palas and Solomon (2022) found that the quality of financial reporting is higher for companies controlled by a DCS structure compared with their single-class counterparts, and that this quality increases over time. Describing this finding as counterintuitive, the authors believe that founders or other controlling shareholders have an incentive to provide investors with higher-quality information in exchange for superior voting rights.

According to Shobe and Shobe (2022), companies often use contractual arrangements to grant certain shareholders "disproportionate" control over the board and/or special powers when making important decisions that are otherwise generally subject to public shareholder approval. They argue that the boundary between single-class and dual-class public companies has become surreptitiously blurred, and many companies that are single-class but grant individual shareholders powers that are as significant as holders of share classes with special rights essentially avoid much of the scrutiny that comes with being a DCS company.

According to Solomon et al. (2020), the ability to predict trends in future earnings from disclosed financial information is on average almost 8% higher for DCS companies than for their single-class counterparts. There are similar findings regarding family-controlled firms in Brazil and Italy, where the quality of the financial information they disclose is superior to any other sub-group, and this quality increases with the age of the firm (Tommasetti et al., 2020).

Imposing constraints (sunset clauses)

Given the renewed appeal in several countries of introducing means of maintaining control (increased voting rights for long-term shareholders and multiple-voting shares), the supervision of companies using these mechanisms has become the focus of intense scrutiny. Vos (2023), for example, sees the presence of controlling shareholders as a way of countering short-termism (provided that these shareholders are not themselves short-termists), and proposes solutions aimed at reviewing the way governance systems are designed (by adding constraints or supervisory measures, among other things) in order to promote the genuine creation of long-term value.

Liang et al. (2022) find that DCS firms outperform single-class firms in their initial public offering, but only for the five to seven years following the IPO. They, like other authors (e.g. Yan [2022]), therefore advocate imposing a sunset clause to eliminate the share class that confers more rights after such a period. It should be noted, however, that the authors do not compare firms beyond this period, and that they find significant differences depending on the nature of the activities of the firms studied and whether or not sunset clauses were in effect at the time of their IPO. Weng & Hu (2022), for example, are more specific and consider the adoption of sunset clauses to be particularly useful with high-tech and innovation firms characterized by high growth rates coupled with low profitability.

Merwat et al. (2023) conclude that Canadian stocks with DCS have outperformed their single-class counterparts, but reiterate their opposition to the use of such structures and strongly suggest the addition of sunset clauses. The authors point out that investors react favourably to the announcement that a sunset clause has been introduced,

signifying the loss of control of the company by its holders. To demonstrate this, they analyzed the difference between the variation in share price on the day of the announcement and the average industry variation observed. The authors consider this resulting "delta", positive in 10 out of 11 cases, as evidence of this favourable reaction. However, they point out that in several cases, these announcements were made at the same time as the disclosure of quarterly or annual results, as well as during the announcement of a major acquisition in another case, events that may have certainly influenced this daily volatility. In addition, the authors do not separate already existing time-based sunset clauses that therefore did not require a formal announcement of their activation. It is hard to establish and isolate investor reaction to a specific piece of information on a share price; it would be ambitious to attribute all the effects of the announcement of a sunset clause activation to the variation of the share price over a single day. What happened to the share price the day after? Did it revert to its original price?

While some benefits of maintaining control are generally recognized, the risks raised by a few high-profile cases (e.g. Rogers and Magna in Canada) mean that many now consider the addition of sunset clauses to be good practice (e.g. Rowe & Sweeney, 2022; Yan, 2020). These cases are, however, anecdotal in number compared to the numerous fiascos involving companies with a single shareholder class. Nevertheless, sunset clauses have been a major focus of debate in recent years (Moore, 2020; Fisch & Solomon, 2019; Kim & Michaely, 2019), and institutional investors are clearly showing their preference for companies that introduce such clauses (Burson & Jensen, 2021).

Other researchers see benefits in keeping DCS structures in place, notably to limit the excessive control exercised by fund managers over listed companies.

Moreover, is it really still possible to speak of companies with widely held ownership in light of the influence and weight of certain shareholders? Bebchuk and Hirst (2022) estimate that BlackRock, Vanguard and State Street collectively held a median 21.9% stake in S&P 500 companies at the end of 2021, representing 24.9% of the votes cast at these companies' annual meetings. These authors confirm that the three managers now exert considerable influence on corporate results and decisions, both through what they do in shareholder engagement and through what they fail to do in terms of stewardship. As these percentages have been rising steadily for several years, the risk associated with a company giving up the control it holds is obvious. This in itself is a very strong argument against imposing a sunset clause.

Battocletti et al. (2023) suggest that the constraints imposed on new companies at the time of their IPO be determined not on the basis of arbitrary rules, but rather, should be a function of the systemic externalities these companies may impose (e.g. a company that would be a major carbon emitter). Such an approach would eliminate the majority of sunset clauses required or expected in current parameters. Yan (2021) also argues that the imposition of sunset clauses based on the passage of time can have consequences contrary to those intended, notably by imposing a de facto short-term horizon on holders of control shares, a possibility all the more true as the predefined term approaches, regardless of its total duration at the time of issue. He therefore urges caution when establishing *ex ante* mechanisms aimed at restricting the powers or eliminating the rights conferred by control shares.

Grinapell (2020) also points out that it would be very risky to attempt to establish a firm term (e.g. forcing new companies to adopt a five- or seven-year sunset clause), and that such regulation would drive many companies to implement a suboptimal structure in addition to increasing their cost of capital (particularly if they were later to attempt to extend the period of continued control). Fullbrook (2018) shows that Canadian controlled family

companies have a longer lifespan than their widely held counterparts. The author also shows that these companies have more stability in the CEO's function. These characteristics are certainly not conducive to limiting the term of control.

The debate over sunset clauses has therefore not been resolved. However, as maintaining control is first and foremost based on a long-term vision, it seems absurd to impose a term of five to seven years, which in no way constitutes a "long-term" period vis à vis the lifespan observed in the majority of family businesses. The variance observed in the duration of the "favourable effect" of a DCS structure after an IPO shows in itself that it is risky to arbitrarily decide in favour of a number of years without taking into account a set of characteristics specific to each company.

Moreover, it should be noted that, in the absence of the possibility of opting for a DCS structure, many of the firms included in these empirical studies would never have gone public.

Social and environmental performance

Few studies have really examined the environmental and social performance of controlled companies. Theoretical approaches, however, anticipate that controlled companies—especially family-controlled—will have a natural interest in social and environmental causes.

Using a sample of Chinese companies, Ma (2023) finds that family firms are more likely (than their non-family-controlled counterparts) to have a system that guides the implementation and development of their corporate social responsibility (CSR) activities. Ma (2023) finds that family-owned companies are also more likely to adopt GRI (Global Reporting Initiative) guidelines and disclose significantly more information about their CSR practices. The author concludes that his findings are consistent with the idea that family firms are more long-term oriented and, consequently, care more about their reputation and use CSR disclosure as a means of establishing and maintaining a good reputation and legitimizing their behaviour.

Moreover, Cordeiro et al. (2018) analyzed 500 large Indian companies, finding a strong relationship between family control and management and the promotion of higher levels of commitment to social responsibility.

According to a perspective that espouses the theory of "socioemotional wealth," family firms are more inclined to adopt proactive stakeholder engagement activities because doing so preserves and improves their socioemotional wealth (Cennamo et al., 2012). The concept of socioemotional wealth refers to a variety of non-financial aspects of business ownership that address the family's emotional needs, such as identity, maintaining influence over the firm and continuing the family dynasty. These include characteristics that can influence CSR, such as the desire to achieve high social status in a local community and to meet needs related to organizational and family identification, for example (Block and Wagner, 2014). To this end, Berrone et al. (2010) found that family-controlled public companies protect their socioemotional wealth by having better environmental performance than their non-family counterparts, particularly in the local context. They also found that the positive effect of family ownership on environmental performance persists independently of whether the CEO is a family member or serves both as CEO and board chair.

Few studies can be found to refute these favourable findings. However, Hettler et al. (2021) observed a negative association, in an American context, between DCS structure and corporate social performance, mainly with regard

to community and employee-related dimensions. In a sample of US companies between 2013 and 2016, Cullinan et al. (2020) also found statistically significant differences in favour of single-share class firms compared to their DCS counterparts when it came to social and environmental ratings. We note, however, that their sample of DCS firm-years is very small compared to that of their single-class counterparts (260 vs. 3,140), and that single-class share companies were on average twice as large in terms of total assets compared to DCS firms. There is a very strong correlation between company size and level of ESG disclosure; this significant difference in company size between the two groups studied suggests that these observations should be treated with caution.

In a context similar to the two previous studies, an analysis of a sample of American firms between 2001 and 2010 led Sah et al. (2022) to conclude that family-controlled firms tend to have a long-term outlook and are more interested than non-family firms in building a good reputation and strong brand image for their descendants, so as to establish their legacy, in keeping with the theory of socioemotional wealth.

Cordeiro et al. (2020), using a sample of 2,755 firm-years in the US during the period 2010-2015, show that companies with family owners and DCS owners, as an ownership structure, interact favourably with gender diversity to positively influence corporate environmental performance and to help advance owners' personal preferences in the area of corporate social and environmental responsibility.

Other researchers have found a similar relationship in a French context, including the fact that family identity and family involvement in capital and management positively influence CSR performance (Brahem et al., 2021).

Analyzing ESG scores for various components (using Vigeo scores) for 363 predominantly European and North American companies, Hirigoyen and Poulain-Rehm (2014), however, found no statistically significant difference between the CSR activities of family firms and those of other firms. Although the average scores of family firms were higher in terms of human resources, community involvement, environment and business behaviour, statistical tests proved insignificant. On the other hand, the authors note significant differences in governance scores, with family firms scoring lower than their counterparts. In this respect, Caffort (2021) points out that a "common refrain is that family-run firms have weak governance structures – a perception that's reinforced by third party rating agencies that routinely pronounce on such matters. Our contention is that a rigid application of rating agencies' governance metrics is much too crude a way of judging how family-owned firms are run and managed." The author also adds that "[n]ot only do these metrics ignore many of the advantages that family ownership brings to corporate management, but they also lose sight of the empirical evidence: family-owned companies generate better returns at lower risk to capital employed."

Using the KLD scores to determine their environmental variables for 232 US firms between 2001 and 2009, Abeysekera and Fernando (2020) found that when it comes to alleviating environmental concerns that have potential to harm society and elevate the firm's risk exposure (what the authors define as convergent interests, i.e. when shareholder interests and societal interests coincide), family firms do at least as well as non-family firms in protecting shareholder interests.

Block and Wagner (2014) also used KLD data to study differences on several ESG components between family and non-family firms among 286 of the largest American firms, in the years between 1993 and 2003. The authors found a negative association between family ownership and community-related CSR performance, but found that family ownership was positively associated with diversity, employee, environmental and product-related aspects of CSR.

Of note in the latter two studies, the authors observed that KLD data were often incomplete, and many observations thus had to be dropped from their respective samples due to missing data.

With respect to sustainability disclosure, researchers have found that Italian family firms are more sensitive to media exposure than their non-family counterparts, and that family control improves sustainability disclosure when this control is associated with direct family influence over the company, through the founder serving on the board of directors or the presence of a family CEO (Gavana et al., 2016).

With a few exceptions, empirical studies tend to confirm a clearer commitment to environmental and social criteria among family-controlled firms.

The exceptions show that, in the worst cases, the level of commitment of family firms is no different from that of other companies or, in certain situations, is no higher on all the environmental or social components examined.

Nonetheless, it should be noted in the majority of cases that this commitment on the part of family-controlled companies was observable long before "responsible" investing became an essential concern, and therefore long before "ESG" made its way into the everyday lexicon. The importance of the reputational aspect in a long-term perspective—over several generations in some cases—necessarily calls on these family-controlled companies to take social and environmental factors into account. Sustainability is in the DNA of these companies and does not have to be imposed by external pressures.

Returns

Over the past 20 years or so, an argument has often been made against DCS structures: they are detrimental to the value of the companies that adopt them. A few empirical studies tend to support this argument, while, according to a review of the literature published between 1986 and 2020 by Lidman and Skog (2022), some of them—numbering 21—conclude that DCS structures are detrimental to company value over time, and that DCS companies trade at lower valuations and offer lower returns. However, these same authors report that a larger number of empirical studies—numbering 28—show DCS structures have positive effects on company value, or no negative effect.

Considering that other literature reviews and meta-analyses arrive at the same findings (e.g. Adams & Ferreira [2008], Adams & al. [2016], Shen [2016], Fisch & Solomon [2019], Hossain & Kryzanowski [2019], Gurrea-Martínez [2021], Reddy [2021]), Lidman and Skog's conclusion seems appropriate: "[f]rom a theoretical and scientific point of view, the argument (or hypothesis) that DCS structures in general damage company value must therefore, at this point, be viewed as unsupported." This again supports the conclusion previously reached by IGOPP (Allaire, 2019).

In fact, the latest studies on the performance of controlled publicly traded companies tend to show that they tend to outperform their one-share, one-vote counterparts, at least over the long term.

For example, on July 31, 2017, S&P Dow Jones Indices announced that companies with a DCS structure would no longer be included in its flagship index, the S&P 500. This announcement provided the context for a study to assess the effect of this measure on the index (Sharfman and Deluard, 2022; Deluard, 2022). Deluard (2022) found that 55 DCS companies achieved the market capitalization that would have qualified them for inclusion in the S&P 500, but were not considered under the new decision rule. These 55 companies outperformed the S&P 500 by 15% between

August 1, 2017, and December 31, 2021. Also according to Deluard (2022), DCS-controlled companies spend more on R&D and tend to grow faster than their one share-one vote counterparts. The author concludes that over a 20-year period, a portfolio of DCS stocks (weighted by market capitalization) outperformed the Russell 3000 Index by 38.8%. Without market capitalization weighting, the return remained 7.2% higher. **S&P Dow Jones Indices reversed its decision in 2023 and is once again accepting qualified DCS companies**.

Analyzing the global corporate world (North America, Europe, Asia-Pacific), Klerk et al. (2020) found that family firms outperformed their non-family counterparts by an average of 370 basis points per year from 2006 to the end of June 2020.

In Canada, using an index rebalanced annually according to pre-established constraints and calculated by S&P Dow Jones Indices, Joli-Cœur et al. (2022) found that, from June 2005 to June 2021, the Index "generated a cumulative total return of 325.1% compared to 221.9% for the S&P/TSX Composite Index. The average annual return for the period was 9.4% for the Family Index, versus 7.6% for the S&P/TSX Index."

Also in a Canadian context, Merwat et al. (2023) found that DCS companies outperformed the benchmark index by an average of 3.7% in 1980-2022 (TSE 300 from 1980 to 2002 and S&P/TSX Composite from 2002 to 2022). The authors also created a market-cap-weighted portfolio[7] of companies with DCS, and compared it to the S&P/TSX Composite Index. Their results show that the portfolio of DCS companies appreciated by 513% between 2002 and 2022, while the benchmark index appreciated by 390%. On an annual basis, this represents a compound annual growth rate (CAGR) of 8.7% for the DCS portfolio, compared with 7.6% for the index.

Beyond the returns associated with share price, Cheng et al. (2020) find that DCS companies invest more efficiently than their single-class counterparts and that this effect is more pronounced among companies with less transparent investments, such as R&D. They also find that, among companies most vulnerable to the risk of overinvestment,[8] DCS companies have higher future accounting profitability and less volatile future returns.

Fullbrook (2018) also demonstrates this lower volatility for family-owned companies in a Canadian context, pointing out that they are less risky for investors. Indeed, the average annual volatility of their sample of family-owned companies was 36% over 33 years, compared with 51% for widely owned companies over 35 years.

Volatility may be partly reduced by the fact that most mature controlled companies pay regular dividends. In a Swedish study between 1998 and 2014, Sekerci (2020) found that family owners holding DCS prefer to channel the company's cash flow into higher dividend payments, that they do so to some extent to meet investor demand, and that this is perceived positively by the market. The author does not, however, control for the nature of the industry or the level of risk associated with investing in the company.

7 The portfolio compiled by the authors was adjusted to remove companies that lost their multiple voting shares during the period.

8 The risk of overinvestment is often used to justify the elimination of multiple voting shares. It is associated with the phenomenon whereby managers or owners voluntarily invest in projects with negative net present value in order to generate private profits or personal benefits at the expense of subordinate shareholders. The "overinvestment" variable is calculated by Cheng et al. (2020) in a two-stage process, first by quantifying cash and leverage according to deciles, then by linear regression modelling.

In a Canadian context, the three recent studies cited above confirm the results observed for over two decades (Allaire [2019] counted six univariate comparisons showing superior returns for Canadian companies with a DCS structure). These findings tend to confirm the advantage observed for this type of company.

Profile of S&P/TSX controlled companies

We looked at all the companies included in the S&P/TSX Index as at November 23, 2022, analyzing their shareholder structure to identify those where a founder or family directly or indirectly exerted a degree of control. This control can be wielded by having two share classes, one of which, for example, grants an additional number of votes compared to the subordinate class (in some cases, both classes have the same voting rights, but one grants the right to make board nominations), or through the direct ownership of at least 20% of the common shares when there is only one share class.

Of the 251 companies making up the index at that time, 90 were considered to be under control according to our criteria. **Table 1** presents some statistics about this group. These companies were founded on average more than 50 years ago, have a total market capitalization of almost $800 billion, and employ just under one million people. The wide gap between the mean and the median in terms of revenues and market capitalization shows that there are significant differences in size between the companies in the sample; the mean is thus pulled upward by the presence of very large companies.

By way of comparison, the average age of non-controlled companies is similar, at 50.07, but the median is below 35. The mean appears to be higher due to the inclusion of companies with special frameworks or ownership structures (e.g. large banks, railway companies). Subtracting these cases, the average age of non-controlled companies is 41.57, a statistically significant difference in average in favour of controlled companies (t=1.868; p=0.032). This result is consistent with the higher longevity observed for Canadian family companies by Fullbrook (2018).

These descriptive statistics once again demonstrate the importance of these companies to the Canadian economy.

Table 1

Descriptive statistics, sample of family-controlled companies (n=90)[9]

	Revenue ($M)	Market capitalization ($M)	No. of employees	Years of existence
Mean	7,661.2	8,878.3	10,789	50.47
Median	1,082.3	2,377.8	2,500	42.50
Total	689,508.7	799,046.1	960,194	4,542.00

Source: compiled by IGOPP, 2023

9 In order to reduce the variations resulting from smaller companies, several analyses in subsequent sections have been conducted excluding those with a market capitalization of less than $500 M. The reduced sample thus consists of 68 family-controlled companies.

Control is exerted through DCS for 69 of the 90 companies identified. **Table 2** shows that this number has remained relatively stable over the last few years, but results from the integration of 14 new companies that opted for a DCS structure between 2019 and 2022, while 12 others left the group.

Table 2

Number of S&P/TSX-listed companies controlled by DCS structures, change since 2019

	2019	2020	2021	2022
Number of companies with two share classes listed on S&P/TSX at the start of the year	67	65	65	71
New companies that went public with shares of two different classes during the year	2	2	10	0
Companies privatized, acquired or having lost controlling share class during the year	4	2	4	2
Number of companies with two share classes listed on S&P/TSX at year-end	65	65	71	69

Source: compiled by IGOPP, 2023

Of the 12 companies no longer included in the Group, as shown in **Table 3**, three have done so voluntarily by eliminating the class of shares that conferred additional rights on their holders.

Table 3

Reasons for excluding companies from group of companies controlled by dual share classes between 2019 and 2022

Reason for exclusion	No. of companies
Company acquired or privatized	6
Proposal submitted to meeting to eliminate class of shares with superior rights (voluntary decision or agreement with founders)	3
Condition resulting in activation of an automatic conversion clause	3
Total	12

Source: compiled by IGOPP, 2023

Of the group of 69, five companies have two classes of shares, one of which confers special rights on the holder to nominate and elect a certain number of directors. The 64 others have a structure in which one class of shares confers voting rights that differ from the subordinate class. The multiple used varies considerably from one company to another, as can be seen in **Table 4**, although the multiple of 10 votes per share for the top class versus one vote for the subordinate shares remains the most popular structure. There are also 19 companies where one class of shares carries one vote, while the subordinate class is non-voting.

Table 4

Number of companies using different voting rights ratios (higher category: lower category)

Ratio	Number
100:1	3
50:1	3
50:0	1
30:1	1
25:1	1
20:1	3

Ratio	Number
10:1	25
9:1	1
6:1	1
5:1	1
4:1	5
1:0	19

Source: compiled by IGOPP, 2023

Of the 90 companies controlled, 21 have a direct holding of at least 20% of common shares. **Table 5** summarizes the number of companies with different levels of shareholding.

Table 5

Number of companies controlled through direct or indirect ownership of at least 20% of ordinary shares

% of ownership	No. of companies
More than 50% of common shares	7
More than 33%, but less than 50%	3
More than 20% but less than 33%	11

Source: compiled by IGOPP, 2023

Canadian controlled companies and ESG factors

To monitor environmental, social and governance performance, we collected data from various sources, as described below:

- **The Sustainalytics risk index**, which measures units of "unmanaged ESG risk." A lower rating therefore represents less unmanaged risk (a lower rating is better than a higher rating);
- **ISS ESG Gateway rating**, giving a literal rating on a 12-point scale;
- **ISS SDG Impact Rating (UN Sustainable Development Goals)**, relative rating where 0 represents zero impact compared with companies in the same industry;
- **Refinitiv E, S, G and combined ESG scores** (Thomson Reuters). Scores out of 100 weighted by industry to enable comparability among companies;
- ***The Globe and Mail's* governance ranking (G)** (Report on Business [ROB] Board Games).

At the end of the data collection process, we observed numerous data gaps in both Institutional Shareholder Services' (ISS) ESG Gateway and SDG Impact ratings. There were also inconsistencies between the data obtained and the other ESG scores, casting doubt on the comparability of the data. According to Larcker et al. (2022), the accuracy of ISS's claims regarding its SDG Impact rating is somewhat more difficult to measure. Prall (2021) found that the correlation between ISS's governance ratings and those of five other ESG data providers (including Sustainalytics, S&P and Bloomberg) varied between 0.07 and 0.33 (a correlation of 1.00 showing a perfect linear relationship between two variables, and 0.00 showing no relationship). We therefore decided not to retain these ratings for subsequent analyses, as they did not provide any additional insight.[10]

PERFORMANCE AS MEASURED BY SUSTAINALYTICS INDEX

The risk index developed by Sustainalytics measures the level of threat to which a company's economic value is exposed due to ESG factors or, technically speaking, the extent of a company's unmanaged ESG risks.

The quantitative rating obtained by Sustainalytics represents units of unmanaged ESG risk. Thus, a lower rating represents less unmanaged risk. Obviously, the risk associated with social and environmental factors is closely tied to the industry in which a given company operates. To assess how family-controlled companies compare with widely

10 Despite the pitfalls and limitations observed with these scores, we compared the data between our two groups. For the data obtained and analyzed with these two ISS ratings, no statistically significant difference was observed between the means of the two groups (controlled family companies versus non-controlled companies).

held companies in terms of ESG risk management, we set up a random matched sample using the NAICS industry classification system [11], and selected comparable companies based on the level of correspondence by hierarchical level (the higher the level, the greater the accuracy and similarity in terms of activities and industry), then taking into account size as measured by market capitalization in a second stage if more than one widely held company served as a direct comparable. Data availability—some companies are not tracked by Sustainalytics—also had the effect of limiting the number of companies included in the final sample.

Compared means are shown in **Table 6**.

Table 6

Comparison of Sustainalytics ESG rating means for two samples of companies matched by industry classification system

	Family-controlled companies		Non-controlled companies	
Hierarchical levels	Mean	n	Mean	n
NAICS code 4+ digits	23.358	24	25.175	24
NAICS code 5+ digits	22.169*	16	26.094	16
NAICS code 6 digits	24.069	13	26.969	13

*The difference in means (family-controlled companies – widely held companies, same sampling method) is statistically significant at 10%.

Source: compiled by IGOPP, 2023

The results obtained, at all the industrial hierarchical levels observed, show a lower mean for family-controlled companies, which would indicate a lower unmanaged ESG risk for these companies. However, we cannot say that the mean obtained for non-controlled companies is higher than that for family-controlled companies, since in two of the three cases we do not obtain a significant result in statistical tests, and the difference is marginally significant in the case of the comparison of companies with codes of five digits or more ($t=1.429$; $p=0.086$).

Nevertheless, it should be stressed that the risk rating is calculated individually for each company, and the factors deemed to be at risk vary from one company to another. As a result, the weightings of each of the different indicators considered as a whole may vary. Sustainalytics indicates that the "G" factor contributes around 20% to the rating attributed to a given company, and this rating includes indicators related to shareholder structure and voting rights (the presence of share classes with unequal voting rights being considered a risk factor). Family-controlled companies are thus "penalized" in the ESG rating they are assigned, but to a varying degree from one company to another.

11 The North American Industry Classification System (NAICS) has been developed by the statistical agencies of Canada, Mexico and the United States, it is designed to provide common definitions of the industrial structure of the three countries and a common statistical framework to facilitate the analysis of the three economies (Statistics Canada).

The various statistical tests conducted on our NAICS samples of six-digit codes show that the mean difference becomes statistically significant for E and S if the proportion of the rating was negatively affected by an average of 7% or more for G due to the existence of a shareholder structure deemed to be "at risk."

According to some studies, (e.g. Caffort, 2021; Hirigoyen and Poulain-Rehm, 2014; Klerk et al., 2020), family-controlled companies tend to score well on social and environmental measures, but systematically underperform on governance. Caffort (2021) shows Sustainalytics' average ratings on governance indicators and compares them between controlled and non-controlled companies. The unfavourable gap for controlled companies is clear and tends to support our own results.

We therefore observe strong sensitivity to the inclusion of factors related to shareholder structure in the assessment of ESG when we compare the quality of ESG risk management by family-controlled companies with those that are not controlled. In the absence of these factors, family-controlled companies appear to have better E & S performance than their widely held counterparts.

REFINITIV E, S, G, AND ESG SCORES

The scores produced by Refinitiv have the advantage of providing a certain degree of comparability between companies, as they are out of 100, obtained by weighting—by industry—several dimensions for each of the components (E, S and G), themselves weighted and grouped together to obtain an overall ESG score out of 100.

As several companies in our sample are not tracked by Refinitiv, a number of them had to be removed for the purposes of calculating comparative averages. We also removed companies with a market capitalization of less than $500 million, to avoid bias based on size. **Table 7** shows the mean comparisons obtained.

It can be seen that, on average, controlled companies score better on environmental factors than their widely held counterparts, and that this difference is statistically significant, albeit marginally (t=1.295; p=0.099). There is no difference in the social score, but the difference is clearly in favour of widely held companies in the governance score (t=2.974; p=0.002). Obviously, this significant difference in the G score results in an overall ESG score that is also unfavourable for controlled companies. This issue has also been noted by Klerk et al. (2020), and the methodological and measurement issues associated with Refinitiv scores have also been the subject of much criticism. The reader is therefore urged to interpret these results with caution. This aspect will be addressed again later.

Table 7

Comparison of individual component means and Refinitiv ESG score (2021) between family-controlled S&P/TSX companies and widely held companies with a market capitalization of $500M or more

	Environment		Social		Governance		ESG score	
	Mean	n	Mean	n	Mean	n	Mean	n
Controlled	0.7199	30	0.5960	51	0.7187	51	0.4817	51
Widely held	0.6408	89	0.6302	153	0.8072	151	0.5243	152
Difference	0.0791*		-0.0342		-0.0885***		-0.0426*	

*The difference in means between family-controlled companies – widely held companies for the same category score) is statistically significant at the 10% level.

**The difference in means (family-controlled companies – widely-held companies for the same category score) is statistically significant at the 5% level.

***The difference in means (family-controlled companies – widely held companies for the same category score) is statistically significant at the 1% level.

Source: compiled by IGOPP, 2023

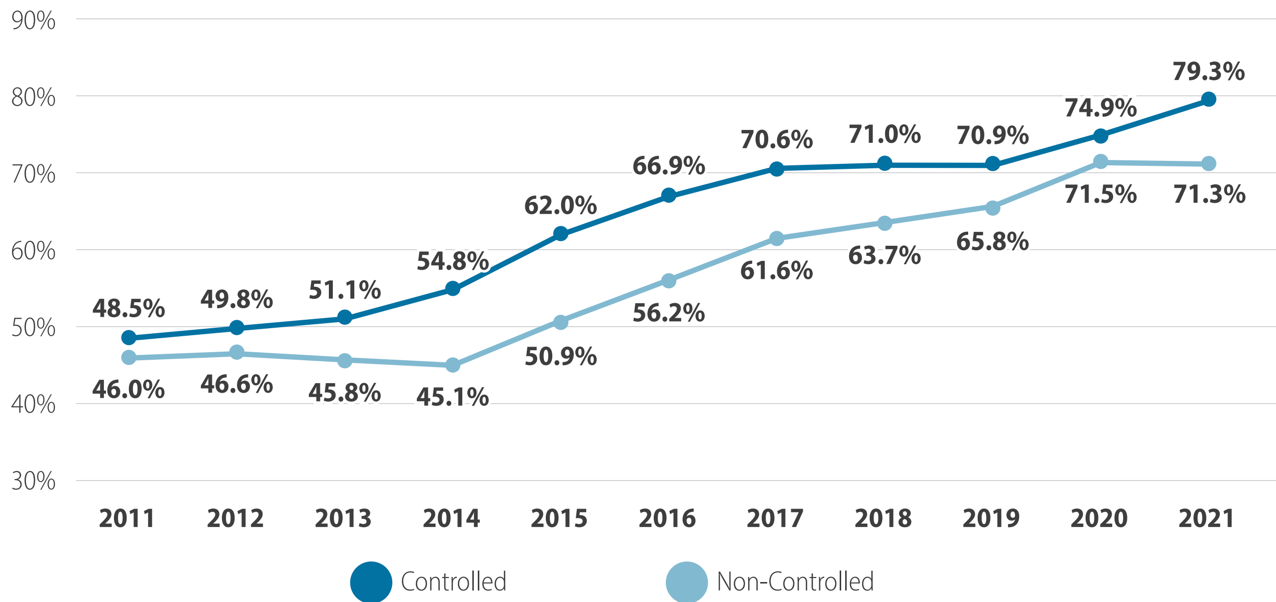
It is especially interesting to observe the evolution of these scores on a historical basis. **Figures 1.1 to 1.4** show the comparative 10-year average[12] by shareholder structure for the E, S and G component scores, and for Refinitiv's combined ESG score.

As shown in **Figure 1.1**, the superior performance of controlled family firms vis à vis their widely held counterparts can be observed over a 10-year period. What's more, the difference between the averages is statistically significant for at least six of these 10 years. As noted by several authors in the literature, the environmental concerns of controlled family firms seem to have been evident for a long time—at least according to our univariate analysis—and, although the score tends to increase with the rising interest in these issues in recent years, it remains higher than that of widely held companies, which are nonetheless subject to significant pressure from external investors in this respect.

12 Companies with a capitalization of $500 M or more, and for which a score has been assigned for the 10 reference years. Compared with Table 7, which included all companies for which data were available in 2021 (this year only), companies that have existed for less than 10 years are therefore excluded from the comparative averages on the graphs in Figures 1.1 to 1.4. This criterion explains the difference observed between the statistics in Table 7 and the various figures for the year 2021.

Figure 1.1

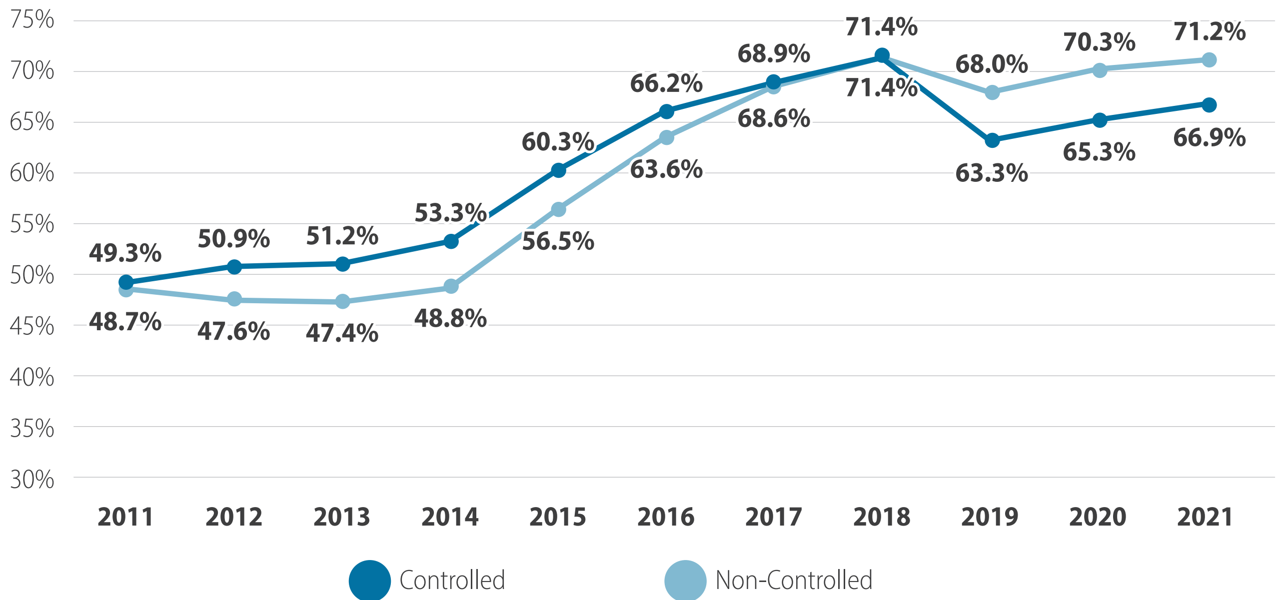
Comparison of Refinitiv's "E" score means, by shareholder structure, for companies at least 10 years old



Source: Refinitiv, 2011-2021; IGOPP compilation for companies that are 10 years old and comprise the main study sample.
Differences in means are statistically significant at 10% or below for the years 2014, 2015, 2016, 2017, 2018 and 2021.

Figure 1.2

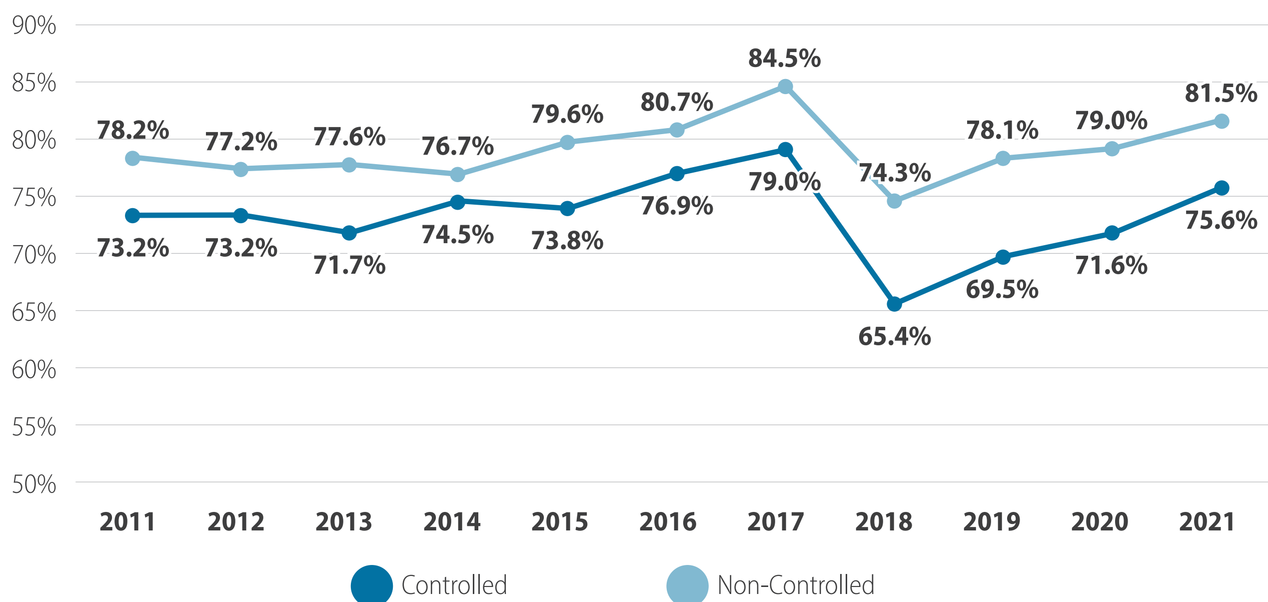
Comparison of Refinitiv "S" score means, by shareholder structure, for companies at least 10 years old



Source: Refinitiv, 2011-2021; IGOPP compilation for companies that are 10 years old and comprise the main study sample.
No difference in means is statistically significant at 10% or below.

Figure 1.3

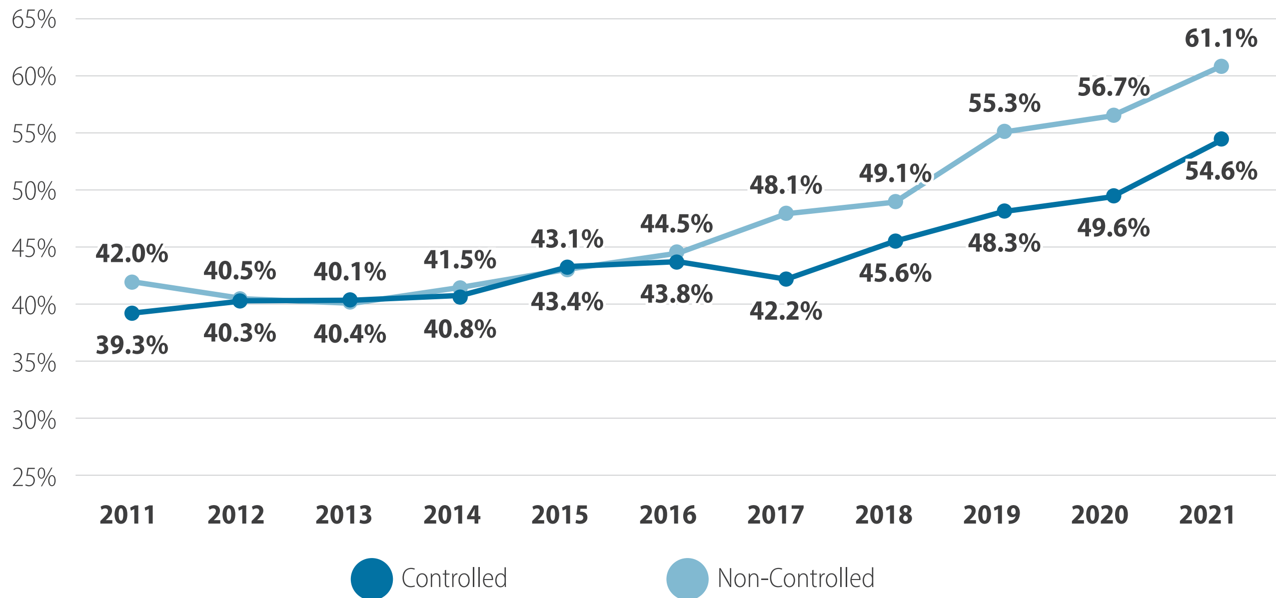
Comparison of Refinitiv "G" score means, by shareholder structure, for companies at least 10 years old



Source: Refinitiv, 2011-2021; IGOPP compilation for companies that are 10 years old and comprise the main study sample.
Differences in means are statistically significant at 5% or below for the years 2011, 2013, 2015, 2017, 2018, 2019, 2020 and 2021.

Figure 1.4

Comparison of means for Refinitiv's combined ESG scores, by shareholder structure, for companies at least 10 years old



Source: Refinitiv, 2011-2021; IGOPP compilation for companies that are 10 years old and comprise the main study sample.
Differences in means are statistically significant at 5% or below for the years 2017, 2019, 2020 and 2021.

Figure 1.2 illustrates an unusual behaviour, as the curve of the two groups being compared decreases sharply from 2019 onward, and the respective position of each group reverses from that point onward. The results observed in previous research showed an advantage for family companies in terms of social factors. While this advantage can be seen for the period 2011-2018 in our sample, we cannot assert that this difference is not simply fortuitous since there is no statistically significant difference between the observed means.

However, the behaviour of the curves from 2019 onward prompted us to delve deeper to understand this abrupt change. It seems that the data provider changed its methodology over the period (notably in 2020, thereby affecting the collection of 2019 results), and that this methodology is dynamic (it evolves in line with the changes observed in ESG disclosure). In addition, the previous methodology assigned scores to companies that did not report on evaluated indicators; wishing to discourage companies from not making ESG disclosures, the new methodology now assigns a score of zero for companies that do not report on indicators relevant to their sector.

Somewhat confusingly, Refinitiv states in its methodological guide (2022) that "scores will be marked as 'definitive' for all historical years excluding the five most recent," and that updates and revisions are done on a weekly basis. Stocks with high ESG scores outperformed in the rewritten data but not in the original data (Larcker et al., 2022).

Berg et al. (2021) set out to document the effects of rewriting scores linked to the methodology implemented by Refinitiv on April 6, 2020. The authors compared two versions of the same Refinitiv ESG data for identical years and companies, one version dated September 2018 and the other September 2020. They found that the change in methodology led to significant retroactive changes in companies' ESG scores, with median overall ESG scores in the rewritten data 18% lower than in the original.

The decreases in the means observed in Figures 1.2 and 1.3 for this pivotal year were not of the same magnitude as those measured by Berg et al. (2021). However, we retain the possibility that this change in methodology with retroactive influences is the source of the inversion of the curves observed in 2019 for the social component (Figure 1.2).

Unsurprisingly, as many authors have observed in the literature, the governance score is on average lower for controlled family companies than for companies with widely held shares (Figure 1.3). Since the majority of controlled companies use DCS mechanisms, and since these mechanisms are heavily penalized when it comes to governance scores, this discrepancy is to be expected. The combined effect of the three E, S and G scores is still to the advantage of companies with widely held shares (Figure 1.4), notably due to the marked difference in the "G" score.

Thus, as in the case of Sustainalytics previously, Refinitiv's ESG rating for family-controlled companies seems to be handicapped not by their social or environmental performance, but by the way their shareholding structure is perceived in the rating agencies' evaluation grids.

THE GLOBE AND MAIL *GOVERNANCE (G) RANKING (BOARD GAMES)*

We do not have a social or environmental ranking specifically dedicated to Canadian companies, but for more than 20 years *The Globe and Mail* has published a detailed governance ranking for the largest companies listed on the S&P/TSX.

As with other governance rankings, a percentage of the points awarded is directly attributable to the shareholder structure of the company being examined. DCS companies are penalized, some by as much as 10%, for this aspect of the ranking alone. The presence of several family members, in certain cases, can obviously result in a board whose composition diverges from the "best practices" set forth for companies with widely held shares. It's no surprise, then, that family-controlled companies systematically fare poorly in this annual ranking.

The *Globe and Mail 2022 Board Games Report Card* mean score for the controlled companies in our sample is therefore 57.98, compared with a mean of 75.89 for widely held companies. The difference between the means is statistically significant ($t=7.135$; $p<0.000$).

According to this standard, Canadian controlled companies are perceived as less well governed than their widely held counterparts.

Performance of Canadian controlled companies

Recent studies of the performance of controlled family companies previously identified in this research (e.g. controlled family companies, [Joli-Coeur et al., 2022]; DCS companies [Merwat et al., 2023]) essentially compare a portfolio created for comparison with the main S&P/TSX Index. This portfolio is therefore composed according to predetermined constraints and periodically reviewed to revise its composition.

As we were also interested in the sustainability of controlled companies, we opted for a different methodology to measure the ability of controlled family companies to deliver long-term returns beyond those generated by widely owned companies that survive over the same period. To do so, two approaches were adopted.

The first, with results presented in **Table 8**, measures the annually compounded total shareholder return (TSR) of all companies in our sample that have been in existence for 10 years or five years, for the 10-year and five-year TSR, respectively. For this approach, returns are weighted according to companies' market capitalization to reflect their relative size (as do the indices), making it possible to include all the firms in our sample.

To avoid the disproportionate influence of the banking sector or, more broadly, the financial sector, the weighted averages are recalculated according to different scenarios (excluding sectors based on their NAICS classification code).

As can be seen, according to this method, family-controlled companies outperform widely held companies on average, regardless of the company composition chosen, for both five- and 10-year horizons.

Table 8

Comparison of total shareholder returns, weighted by market capitalization and compounded annually, over five and 10 years to December 31, 2021 (S&P/TSX companies)

Weighted total shareholder return, compounded annually	All companies		Excluding banking sector[a]		Excluding finance and insurance sectors[b]	
	Family-controlled	Widely owned	Family-controlled	Widely owned	Family-controlled	Widely owned
5 years (%)	20.86*	11.16	20,86*	10.84	23.27*	11.01
n	68	148	68	135	55	128
10 years (%)	14.48**	12.44	14.48**	11.77	15.22**	11.70
n	57	132	57	120	46	113

a Excludes all companies classified under the four-digit NAICS code 5221 or 5222

b Excludes all companies classified under the two-digit NAICS code 52

* The difference in returns (family-controlled companies – widely held companies, same sampling method) is statistically significant at 10%.

** The difference in returns (family-controlled companies – widely held companies, same sampling method) is statistically significant at 5%.

Source: compiled by IGOPP, 2023

In order to prevent the high returns achieved by a few large companies (e.g. Alimentation Couche-Tard, Shopify, etc.) from driving the overall results upward, we took a second approach to observe the TSRs of both groups, giving each company equal weight in the average. However, to reduce the variance introduced by very small firms, we excluded companies with a market capitalization of less than $500 million from both groups. **Table 9** presents the results obtained.

Table 9

Comparison of mean total shareholder return (TSR), compounded annually over five and 10 years, for S&P/TSX companies with a market capitalization of $500 M or more

	All companies with market capitalization $500 M or more		Excluding banking sector[a]		Excluding finance and insurance sectors[b]	
Mean compounded annually TSR	Family-controlled	Widely owned	Family-controlled	Widely owned	Family-controlled	Widely owned
5 years (%)	12.36	10.80	12.36	10.35	13.55	10.24
N	52	148	52	135	41	128
10 years (%)	12.08*	9.34	12.08**	8.77	11.90*	8.67
n	41	132	41	120	32	113

a Excludes all companies classified under the four-digit NAICS code 5221 or 5222

b Excludes all companies classified under the two-digit NAICS code 52

* The difference in mean returns (family-controlled companies – widely held companies, same sampling method) is statistically significant at 10%.

** The difference in mean returns (family-controlled companies – widely-held companies, same sampling method) is statistically significant at 5%.

Source: compiled by IGOPP, 2023

The mean returns calculated in this way are slightly lower than those obtained using the previous approach, but controlled companies still outperform widely held companies on average. The difference between the means, however, is statistically significant only for the means obtained over 10-year periods.

These results are consistent with those obtained both in earlier research and in more recent studies, and thus tend to confirm the higher long-term returns generated by controlled Canadian companies.

Relationship between controlled-company returns and governance score in a Canadian context

We then observed whether there was a relationship between the ROB governance score and shareholder return. For greater accuracy, we also broke down the ROB ranking into three sections (score out of 19 for "shareholder rights," total score without the "shareholder rights" section, therefore out of 81, and the full score out of 100). The results are shown in **Table 10**.

Table 10

Correlation coefficient (r) between *The Globe and Mail*'s governance rankings (Report on Business Board Games, 2022) and total shareholder return (TSR), compounded annually over five and 10 years

	n	Ranking – shareholder rights (out of 19)	Ranking – without shareholder rights (out of 81)	Total (out of 100)
5-year TSR	189	-0.0955*	-0.1336**	-0.1355**
10-year TSR	165	0.0526	0.0760	0.0764

* The relationship between the two variables is statistically significant at 10%.

** The relationship between the two variables is statistically significant at 5%.

Source: compiled by IGOPP, 2023

In a multivariate statistical analysis, Allaire and Firsirotu (2003) tested the relationship of the ROB ranking with seven different performance measures in a sample of 177 Canadian companies in 2002 (in the early years of the rankings' publication). The authors concluded that "[w]hatever the performance measures, whatever the sophistication of the analyses, we found that the 'quality' of governance as measured by ROB rankings had no statistically significant relationship to performance."

Table 10 shows that the relationship between the ROB ranking and 10-year TSR is not statistically significant. The relationship between the overall ROB ranking out of 100 and the five-year TSR is, however, *negative and statistically significant* ($r=-0.1355$; $t=1.871$; $p=0.031$), even if this relationship is rather weak (the increase in the overall governance ranking translates into a decline in shareholder return over five years). An observation that, 20 years later, still supports Allaire and Firsirotu's (2003) conclusion.

Findings, discussion and conclusion

WHAT CAN BE LEARNED FROM AN IN-DEPTH REVIEW OF RECENT STUDIES?

In general, studies tend to confirm:

- A favourable effect of maintaining control on innovation capacity and better quality of financial information (including the predictive utility of data) disclosed by controlled companies;
- Greater longevity of controlled companies compared to their one-share, one-vote counterparts;
- An improvement in the quality of information disclosed with the age of these controlled companies;
- A more marked commitment to social and environmental criteria among family-controlled companies. The exceptions encountered show that family firms' level of commitment to E & S criteria is, in the worst case, undifferentiated from other firms, or, in some situations, not superior on all the environmental or social components examined. Nevertheless, in most cases, it should be noted that this commitment on the part of controlled family companies was observable long before "responsible" investment became an essential dimension, and therefore long before "ESG" made its way into the everyday lexicon. The importance of the reputational aspect in a long-term perspective—over several generations in some cases—necessarily calls on these family-controlled companies to take social and environmental factors into account;
- There is no compelling support for the hypothesis that DCS structures are detrimental to corporate value;
- Controlled Canadian companies, including those with DCS structures, show higher long-term total shareholder returns than their widely held counterparts;
- Shares of controlled companies tend to be less volatile and therefore present a lower level of risk for investors;
- Given the evidence of better financial results for companies with DCS, the debate has increasingly moved toward the imposition of sunset clauses aimed at restricting the maintenance of control to a predetermined time horizon. In this respect, discussions are more theoretical in nature, with little empirical support;
- Nevertheless, it is clear from the arguments that the desire to maintain control rests first and foremost on the ability to endow and execute a long-term vision for the organization, and that imposing a time limit—especially a short one—runs counter to this de facto primary quality.

KEY FINDINGS OF OUR STUDY OF S&P/TSX CONTROLLED COMPANIES

In terms of stock market performance, as previously stated, our results support those of the studies reviewed and demonstrate that Canadian S&P/TSX controlled companies outperform their non-controlled counterparts in terms of long-term total shareholder return.

Based on the results of a comparison of samples of companies matched according to the industry classification system, Canadian S&P/TSX controlled companies have a better unmanaged ESG risk index than their uncontrolled counterparts, despite the fact that the index is biased against controlled companies.

Furthermore, for more than a decade, and especially in the 2021 reference year, Canadian S&P/TSX controlled companies have had a higher environmental “E” score than non-controlled companies.

The analysis of social performance has been complicated by the problems associated with the different measures observed, as well as by the methodological choices made by the rating agencies. Indeed, biases are introduced by the ability (or willingness) of companies to disclose their activities in detail or not, and it seems that the rating is strongly influenced by this aspect (and not by the social initiatives and commitments themselves). Nevertheless, at no time in the past 10 years, nor in the reference year, can it be said that non-controlled companies are superior to controlled companies in terms of social performance according to Refinitiv’s “S” score. On the contrary, prior to the data provider’s methodological change, controlled companies tended to have a higher average.

However, and unsurprisingly, since being controlled (particularly through a DCS structure) has a negative effect on the “G” component of the various ratings, controlled companies are assessed—according to the catechism of governance assessment agencies—as being less well governed than their widely held counterparts. The net effect of the “G” rating on the combined ESG rating skews the total results and paints an unfavourable and unfair picture of controlled companies.

There is also a negative relationship between *The Globe and Mail* ranking and total shareholder return over five years. There is no association between the same ranking and 10-year returns.

CONCLUSION

The exhaustive review of recent empirical studies and the results of our analysis in a Canadian context speak for themselves: they do not support the ambitions of the CII and Investor Coalition for Equal Votes to eliminate DCS structures, nor their quasi-dogmatic approach to the question. On the contrary, the findings should reassure investors and stakeholders in controlled companies.

Compared to widely held companies, for example, controlled companies have longer lifespans, on average, with higher long-term returns and better environmental performance, without neglecting their social performance. The literature also observes that these controlled companies have lower volatility, better quality financial disclosures and a greater capacity for innovation over the long term.

But these companies are considered to be poorly governed according to their ratings, and maintaining control through a DCS mechanism—considered as a "flaw"—is also reflected in their overall ESG rating.

Yet wouldn't it be fairer if the quality of governance were correlated with long-term returns and good stakeholder performance (E and S components)?

The connection between the quality of a company's governance and its performance seems natural, even obvious. What is less evident is how to correctly assess this level of governance quality using a rating. To do so, one would need to be able to capture all the subtleties of a group's dynamics, the inherent competence of each board member, the collective intelligence and wisdom of the directors, their shared understanding of the business model, their ability to demonstrate courage at the right time, and so on.

As the credibility of directors, for example, remains a difficult concept to assess, "good governance" standards have been developed by rating agencies in a way that can be measured simply. The parameters established over the years are factors *that can contribute to better governance*, but *which are no substitute for governance itself*. Without taking into account the specifics of the companies thus assessed, they are assigned a rating based to arbitrary standards and scales, often determined according to grids that meet the imperatives established by specialized governance firms that must compile thousands of data sets annually.

The Globe and Mail Report on Business (ROB) ranking closely resembles the standardized grids found in other jurisdictions and designed by other corporate governance rating agencies. Obviously, the weightings of the rankings differ and, above all, the companies assessed using this ranking are all Canadian. It's astonishing that, after some 20 years' experience, *The Globe and Mail* has yet to make true changes to its yardstick, which is increasingly at odds with the actual experience of governance in Canada.

To begin with, it is important to separate the "G" component from social and environmental components when assessing the performance of controlled companies. Governance must be assessed on the basis of the specific characteristics of each of these companies; there may be as many models of good governance as there are companies, but each must adopt the governance that suits it and that will demonstrate its effectiveness and ability to create long-term value. **Total shareholder return over the long term, like social and environmental performance, is a consequence of the effectiveness of the governance model in place**.

The importance of controlled family companies to the Canadian economy is undeniable. The fact that they have a longer lifespan and a significant impact on all stakeholders, that they are concerned with environmental issues and that they invest with a time horizon that sometimes spans several generations, is an additional quality that should encourage governments and other regulatory authorities to ensure this model is preserved and encouraged. Tax measures that encourage intergenerational transfers without risking the loss of control, as adopted in several European countries, are an example of decisions that would encourage the preservation of these structures over the very long term.

Furthermore, companies wishing to go public in the near future, as well as future entrepreneurs, need to be fully aware of the advantages of maintaining control in order to bring their project and vision to fruition. The appeal of shares in a company with a good business model and innovative products or services will persevere despite the use of a DCS structure.

We must not allow ourselves to be distracted by the rhetoric of third parties who want to bring about an end to a vision.

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Created in 2005 by two academic institutions (HEC Montréal and Concordia University – The John Molson School of Business) and the Stephen Jarislowsky Foundation, 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.

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