Institute for governance
of private and public organizations

Going public: a thing of the past?

Initial public offerings and recent developments in dual-class share structures

by

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Table of content

Introduction

In Canada, 2023 was a lean year for new companies embarking on initial public offerings (IPOs) on the TSX, the country's main stock exchange. In fact, only one company, Lithium Royalty Corp., proceeded with an IPO, raising about $150 million in March 2023. More than a year later, at the end of June 2024, no new conventional[1] company has since been listed via IPO on the TSX. This is an abnormally long—even historic—period.

"The public markets are a great economic equalizer, allowing small retail investors, supported by appropriate investor protections, to participate directly in the growth of [the] economy" (Capital Markets Modernization Taskforce, 2021). Studies show that the size of a country's capital market is positively correlated with its economic development (measured by the long-term real growth rate of GDP per capita), and that, in the case of stock markets, the relationship is estimated at 1:1 (Kaserer and Rapp, 2014). Healthy, attractive markets are essential, as they also promote innovation, economic diversification and greater sharing of created wealth, while making a country's economy more resilient to shocks (European IPO Task Force, 2020).

For entrepreneurs, an IPO offers many advantages. First and foremost, of course, it is a means of financing growth, but it also enhances brand awareness and reputation (Pešterac, 2020). Compliance requirements imposed by regulators and stock market operators lend companies a high degree of credibility, making it much easier to recruit and retain employees and managers. It is also an undeniable plus when negotiating with local and foreign suppliers.

Of course, an IPO inevitably comes with additional costs associated with public disclosure requirements and other compliance obligations, not to mention the risk of hostile takeover attempts or having to deal with an attack from an activist shareholder. Table 1 lists some of the most frequently raised arguments for and against an IPO.

1 A conventional company refers to a company with traditional business activities (manufacturing products, providing services, retailing, financial and banking services, etc.), which excludes financial vehicles such as exchange-traded funds, special-purpose acquisition companies, mutual funds, split-share companies, closed-end investment trusts, and so on.

Table 1

Some of the advantages and disadvantages frequently associated with a company going public

Advantages	Disadvantages
• Raising substantial capital to achieve long-term development goals • Reduced debt ratio, greater flexibility for optimal use of financial leverage • Determining a market value for the company while making shares more liquid • Retaining key employees facilitated by the possible use of share-based incentive compensation plans • Prestige, recognition and visibility for the company – greater bargaining power with suppliers, more appealing to some customers • Easier international expansion • Governance that meets the highest standards, greater transparency • Shareholder diversity, greater dispersion	• Risk of the company being the target of a hostile takeover bid • Risk of the company being under valued • Significant costs associated with the IPO process • Recurring costs associated with compliance obligations • Stronger pressure to deliver short-term results • Disclosure of information that the company would rather keep confidential • Risk of the company being targeted by activist shareholders • Risk of being presented with shareholder proposals by various pressure groups, on a wide variety of subjects, which will require a response • Risk that some constraints or regulations apply only to listed companies, making the company less competitive with private players

Source: compiled by IGOPP, 2024

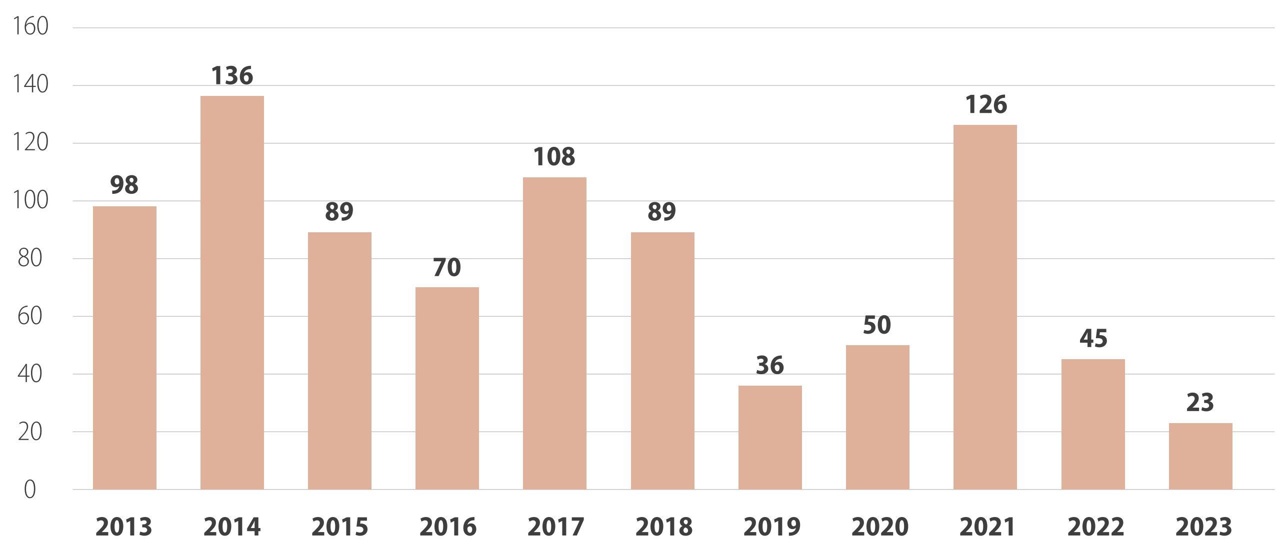
Economic uncertainty is certainly a decisive and unfavourable factor with a recognized impact on the number and value of IPOs (Demir & al., 2023). This uncertainty could have partly explained the small number of IPOs in 2022, and even in 2023, but these two years are part of what appears to be more of a longer-term trend, with deeper issues at stake.

Canadian and international IPO data

Canada is not the only country experiencing a steady decline in the number of IPOs. In the UK, the dwindling number of IPOs is a major concern. Indeed, as **Figure 1** shows, the number of new IPOs on the London Stock Exchange dropped by half between 2022 and 2023 (after an off-peak post-pandemic surge in 2021), despite significant measures adopted by the Financial Conduct Authority (FCA, the UK's financial markets regulator) in recent years, in the hope of stimulating IPOs on its markets.

Figure 1

Total number of IPOs on London Stock Exchange (LSE) in UK, 2013 to 2023



Source: adapted from Statista Research Department, 2024

The meetings and consultations held with potential new issuers by various public authorities around the world show that the disadvantages presented in **Table 1** now seem to outweigh the advantages in the minds of many entrepreneurs. Among the things that have been observed:

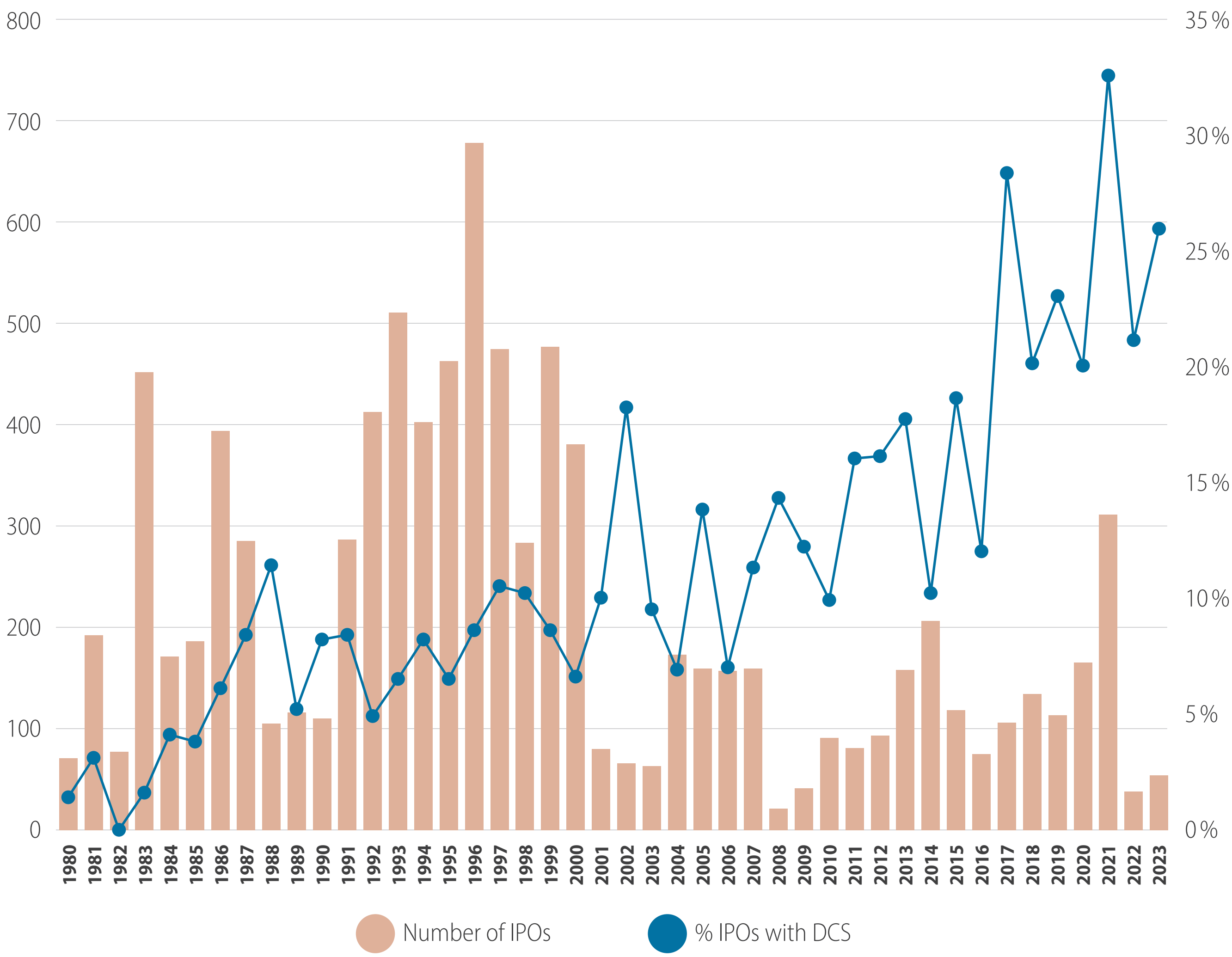
- Some institutional investors, by virtue of the size of their assets under management—particularly in the form of index funds—exercise considerable voting power (nearly a quarter of recorded votes according to some studies [e.g. Bebchuk & Hirst, 2019]) and can thus strongly influence the policies and major orientations of listed companies;
- Financial analysts eagerly await quarterly results and publicly disclose their expectations, exerting constant pressure to deliver satisfactory results in the short term;
- Activist shareholders can intervene at any time—particularly during difficult periods or when short-term results fail to meet analysts' expectations—with demands of various kinds, such as share buybacks, payment of an extraordinary dividend, board member appointments or major strategic changes;
- Short-sellers can spread inflammatory and alarmist reports—founded or unfounded—about the company without warning, with the potential to generate a major reputational crisis in addition to creating uncertainty for employees, customers, suppliers and shareholders;
- Pressure groups can submit shareholder proposals on a wide variety of subjects, to which shareholders will have to respond, or demand that management express an opinion on political or social issues;
- The risk of receiving an unsolicited bid is very real;
- The media keep a close eye on every new public disclosure;
- Disclosure and compliance obligations are constantly growing, taking up more and more resources.

In many situations, control over the company is the only way to stay focused on a long-term vision without letting these potential disruptions take over the day-to-day.

This is why, in the US, at least one in five companies has opted for a dual-class share [DCS] structure (one of which usually confers a superior voting multiple) since 2017. This proportion rose as high as 32.5% in 2021 and seems to be maintaining an upward trend. Figure 2 shows both the decline in the number of IPOs over the years in the United States and the rise in the proportion that were carried out using DCS structures.

Figure 2

IPOs in the United States[a] between 1980 and 2023, and percentage of companies opting for a DCS structure



[a] Including all listings on the Amex, NYSE and NASDAQ exchanges

Source: adapted from data compiled by Ritter, 2024

In Canada, the percentage of companies opting for a DCS structure on the TSX also usually hovers around 20%. It reached 36.1% in 2021, but with the number of IPOs very low over the past two years, this statistic is not all that significant. The pitifully low number of new IPOs mentioned in the introduction to this document is very apparent in the data presented in **Table 2**.

Table 2

Number of IPOs between 2021 and 2023 in Canada and number of companies opting for dual class shares in their IPOs on the TSX

	2021	2022	2023
IPOs in Canada	170	120	51
Minus: REITs, FNBs and mutual funds, SPACs[a]	(85)	(69)	(29)
SUB-TOTAL	85	51	22
Minus: IPOs on TSXV, CSE and NEO/Cboe	(49)	(49)	(21)
IPOs on TSX	36	2	1
IPOs with DCS on TSX	13	0	0

[a] REIT: Real Estate Investment Trust; ETF: Exchange Traded Fund; SPAC: Special Purpose Acquisition Company. Also excluded are closed-end investment trusts and other financial vehicles..

Source: IGOPP compilation, raw data from https://www.investcom.com/

As seen in **Table 3**, the situation does not seem to be improving in the first half of 2024, with no IPOs (by a conventional company) recorded on the TSX during this period.

Table 3

Number of IPOs per quarter in 2024 in Canada and number of companies opting for dual class shares in their IPOs on the TSX

	Q1 2024	Q2 2024	6 mths 2024
IPOs in Canada	9	6	15
Minus: REITs, FNBs and mutual funds, SPACs[a]	(6)	(3)	(9)
SUB-TOTAL	3	3	6
Minus: IPOs on TSXV, CSE and NEO/Cboe	(3)	(3)	(6)
IPOs on TSX	0	0	0
IPOS with DCS on TSX	0	0	0

[a] REITs: Real Estate Investment Trusts; ETFs: Exchange Traded Funds; SPACs: Special Purpose Acquisition Companies. Also excluded are closed-end investment trusts and other financial vehicles.

Source: IGOPP compilation, raw data from https://www.investcom.com/

If entrepreneurs wish to maintain control of their company after its IPO, the pressure to dissuade them from doing so is very strong. Indeed, many institutional investors and other actors such as proxy advisory firms argue that deviation from the "one-share, one-vote" rule should be avoided at all costs. While the evidence is mounting—at least in Canada—to demonstrate the superior long-term performance of controlled companies (through mechanisms such as share classes with multiple voting rights, or through direct ownership of a significant stake conferring de facto control), these same capital markets key players are today stepping up pressure to eliminate all mechanisms that confer unequal voting rights.

As a result of these pressures, legal advisors and others are urging new Canadian issuers to introduce temporal sunset clauses from the outset, i.e. clauses ensuring the automatic conversion of shares with superior rights into shares with only one vote (a single class of shares) after a predetermined period has elapsed. According to standard guidelines (e.g. ISS or Glass Lewis), this period is arbitrarily set at five or seven years.

To convince entrepreneurs to avoid multiple voting shares, they are often made to fear that the issue may not reach its full potential, that investors will want to discount the share price due to the presence of a subordinate share class. While academic research on the subject is often inconclusive, data aggregated between 1980 and 2022 on all IPOs in the US certainly do not show that automatic discounting is associated with the choice of a DCS structure, as seen in **Table 4**.

Table 4

Use of DCS for IPOs in the United States[a], average yield on day of listing and over three years, 1980-2022

	No. of IPOs	Average yield day 1	Average yield three years
DCS	891	20.0 %	30.6 %
One share, one vote	8,236	18.9 %	18.4 %
1980-2022	9,127	19.0 %	19.6 %

[a] Including all listings on the Amex, NYSE, and NASDAQ exchanges

Source: Ritter, 2024

Regardless of structural issues, resorting to private markets and numerous new sources of capital have convinced many entrepreneurs to shun IPO financing and thereby avoid all the risks identified above, as well as the various obligations associated with being a public company.

In a bid to modernize Ontario's capital markets and stem the decline in the number of new issuers, the provincial government established the Capital Markets Modernization Task Force in February 2020, which published its final report in January 2021. In his introductory message, Walied Soliman, chair of the task force, underscored the importance of the process:

> The decline in new issuers and initial public offerings in Ontario is alarming. The real consequences of this trend are fewer head offices, fewer entrepreneurs, and fewer growth investment opportunities, all of which could drive Ontario to become a "branch plant" economy.

In its 74 recommendations, the task force calls for major reforms. Some of them have been adopted, but several are still on the drawing board.

Regulator reactions elsewhere in the world

In Canada, current legislation and regulations do not restrict the adoption of mechanisms to maintain control. Rather, this restriction is applied indirectly, through pressure exerted by certain underwriters, or through the rhetoric of external advisors who raise fears of a potential loss of value, as mentioned above. As a result, many new issuers have relented and agreed to add a sunset clause, believing it to be an unavoidable option.

In many countries, however, the use of DCS structures was prohibited until recently.

Like Ontario, which has set up a task force to address this question, most countries are looking for solutions to the declining interest in public markets.

Many adjustments have been proposed and implemented, all in the hope of reviving this appeal to entrepreneur-founders. To give them continued control, countries that previously fiercely opposed any form of deviation from the one-share-one-vote principle have decided to open a door.

The following section highlights the most recent developments on this subject.

NEW DEVELOPMENTS IN THE UK, SOUTH KOREA, GERMANY, FRANCE, ITALY AND, MORE BROADLY, EUROPE

United Kingdom

In December 2021, the UK regulator (*Financial Conduct Authority* [FCA]) allowed the introduction of companies using multiple-voting share classes on the premium segment (main stock exchange). However, the use of DCS structures came with severe constraints, and the effects of this new regulation were ultimately very limited, as hardly any companies listed under the new formula. In May 2023, the FCA therefore launched a consultation process, again with the aim of making stock markets attractive to new issuers and thereby supporting economic growth and innovation. The FCA also stated that “access to a potentially wider range of listed companies will provide greater opportunities for investors in UK markets and help create jobs and growth.”

One of the aims of this consultation is to relax the rules governing the use of multiple voting shares by new issuers. The proposals submitted to the May 2023 consultation, vis à vis DCS, can be summarized as follows:

- Relax the mandatory sunset clause (from five to 10 years)
- Eliminate the maximum 20:1 ratio
- Modify holding and transfer conditions.

A few months later, in December 2023, the results of the consultation were published. The FCA reports that 42 responses and briefs were submitted, of which 20 were in favour of the proposed relaxations, 14 were against any form of relaxation, and eight expressed mixed views.

The following excerpts summarize the FCA's assessment of the responses received during the public consultation.

> "There were strong views particularly from buy-side respondents that encouraging more permissive [DCS] models could be detrimental to investors' ability to engage with an issuer's management and may reduce company value in the long term.
>
> […] Others, mostly in the sell-side, advocated a disclosure-based regime, arguing that current limits were seen as the biggest stumbling block for a UK listing in the minds of many founders […]. These views therefore suggested no restrictions at all.
>
> […] On balance, **we were convinced by the arguments put forward by those who advocated for a more flexible approach to [DCS]** for the purposes of a single equity category for commercial companies. Specifically, we agree that the maximum 10-year sunset period we proposed in CP23/10 may still be arbitrary, and risks both deterring some companies that may have case-specific reasons to consider longer periods […]. We also recognise that, although taken into consideration when setting our current rules, **academic evidence is not conclusive in this area.**"[3]

This led to new proposals, which were again submitted to a public consultation (CP23/31) launched in December 2023. This time, the proposals are much more permissive, and most of the constraints associated with DCS have now been lifted. In summary, the plan is to:

- eliminate the need to include a temporal sunset clause;
- modify the conditions associated with holding, i.e. that DCS can only be issued to:
  - directors of the issuer;
  - individuals who are investors or shareholders of the issuer;
  - employees of the issuer, or;
  - legal entities established for the sole benefit of, or owned and controlled solely by, a person in (i), (ii) or (iii) above.;
- allow superior voting rights to be exercised only by the natural person to whom the shares were issued at the time of the initial request.

This essentially eliminates any constraint, even with respect to the temporal sunset clause, confirming the lack of conclusive academic evidence on the issue. Furthermore, the requirement that voting rights be exercised by the natural person to whom the shares were initially issued creates a kind of eventual sunset clause, either in the event of the death or disability of the natural person in question, or the sale or transfer of the shares. Intergenerational transfer of control via the DCS is therefore impossible under this new formula, which is still far more permissive than the version introduced in 2021.

3 (emphasis added).

On July 11, 2024, the FCA published its final Policy Statement. The FCA thus sets out its "final rules for a new, simplified and more competitive UK listing regime".

The final position by the FCA is broadly as consulted on in CP23/31, with certain amendments. In response to the feedback received, the FCA opted to allow "institutional investors (i.e. legal persons) to hold enhanced voting rights to ensure that they are not disincentivised from supporting pre-initial public offering (IPO) funding rounds or bringing companies to listing in the UK."

The key features of final rules regarding DCS structures are described by the FCA below (additions or changes from public consultation launched in December 2023 are shown in underline):

> Permitting issuers to have dual/multiple class share structures at admission. Enhanced voting rights only to be held by specified natural persons without a time-based sunset clause, <u>or pre-IPO investors that are legal persons subject to a maximum 10-year period after which enhanced rights should expire</u>. Retained voting restrictions on certain matters, including dilutive transactions and cancellation of listing.

The new rules will come into force on July 29, 2024.

South Korea

In 2021, the management of Coupang, an up-and-coming Korean company, decided to proceed with an IPO on the NASDAQ in the US, using a DCS structure, since this type of structure was prohibited in South Korea. The situation elicited an outcry from the CEO of the Seoul Stock Exchange (KRX), who called for more favourable legislation to attract young Korean companies to list locally.

The debate eventually spurred the government to take action. Young Lee, Korea's Minister of SMEs and Start-ups, stressed the importance of new legislation fostering an environment in which high-growth venture businesses can leverage the power of the South Korean capital market and emphasized that the system of multiple voting shares is actively used in the USA, as well as in China and India.

On November 17, 2023, the *Amended Act on Special Measures for the Promotion of Venture Businesses* came into effect, allowing an exception to the "one-share-one-vote" rule of the *Korean Commercial Code*, which nonetheless comes with several constraints:

- Maximum 10:1 ratio for votes associated with the multiple-voting share class;
- Automatic conversion clause on transfer of shares (not permitted) or on founder's resignation;
- Mandatory sunset clause (maximum 10 years), reduced to three years for publicly traded companies.

South Korea thus joins a long list of Asian countries that have decided to allow DCS structures in recent years.

Germany

On May 31, 2003, the German Stock Corporation Act established the principle of "proportional voting rights," whereby each common share confers one voting right. From that moment on, DCS were prohibited.

However, competition from other markets to attract new issuers sparked a fear among authorities that this would reduce the number of IPOs in Germany, an economy renowned for the strength of its small and medium-sized enterprises.

The coalition government in place since the end of 2021 has therefore developed a comprehensive strategy to support start-ups, their founders and innovation. The reintroduction of DCS structures was among the core elements of this strategy, and a first bill along these lines was tabled in April 2023. The government wanted to act swiftly on this question, so the bill was passed in the ensuing months and, since December 15, 2023, DCS have been authorized in Germany following the adoption of the Financing for the Future Act (*Zukunftsfinanzierungsgesetz*).

The law allowing DCS, which was partly inspired by the first draft proposed in the United Kingdom, contains restrictions:

- Maximum 10:1 ratio for votes associated with the multiple-voting share class
- Automatic conversion clause (transfer of multiple voting shares is not allowed);
- Mandatory sunset clause (maximum 10 years from IPO), with the possibility of adding a further 10 years upon approval by 75% of shareholders.

All segments of the public markets are eligible to introduce DCS (including DAX companies).

Europe

At the beginning of 2024, the Council of the European Union and the European Parliament reached a provisional agreement on the directive on multiple-voting share structures. With a view to making public growth markets more attractive, this agreement is aimed at ensuring that all member countries have a legal and regulatory environment that allows for DCS structures. Following are a few excerpts from the news release issued to this effect on February 1, 2024:

> "The Markets in Financial Instruments Directive (MiFID II) and the Markets in Financial Instruments Regulation (MiFIR) allowed for the creation of 'SME growth markets', a trading venue facilitating access to capital for SMEs. However, many entrepreneurs do not list their companies on these markets for fear of losing control due to the entry of new shareholders. One instrument to prevent this is the multiple-vote share structure, which enables controlling shareholders (i.e. company founders) to have more votes per share than new investors.
>
> Currently, some Member States allow multiple-vote share structures, while in others they are prohibited. The Directive aims to reduce inequalities for companies seeking to raise funds on SME growth markets by creating minimum harmonisation in the Single Market that removes obstacles to SME growth markets access generated by regulatory barriers."

Under the provisional agreement, each member state will have to decide on various aspects, including the maximum voting ratio and the inclusion of additional binding measures, such as 1° sunset clauses; 2° automatic conversion clauses; and 3° limitations on the holders of such share classes.

With the adoption of its law in December 2023, Germany was therefore acting pre-emptively.

Italy

The Italian government sought to adopt measures to stimulate the growth of Italy's capital market, by promoting companies' access to and continued presence in financial markets. On February 27, 2024, Parliament passed a draft bill on capital markets (*DDL Capitali*), which came into effect on March 5. Since then, companies have been able to carry out IPOs on the Italian markets using an DCS structure with a maximum ratio of 10:1.

France

In September 2022, a task force commissioned by the *Haut comité juridique de la place financière de Paris* published an impressive report on the use of multiple voting structures in several countries and the possibility of introducing them in France. In its conclusion, "[the] task force considers that, in view of the trend to establish the practice in most financial markets, it would be appropriate to introduce into French law governing listed companies the possibility of attributing multiple voting rights to certain shares."

Following on from this report, and in the wake of the provisional agreement reached between the Council of the European Union and the European Parliament on the directive on multiple-voting share structures, a proposed law to increase the financing of companies and the attractiveness of France was submitted to the National Assembly on March 12, 2024. In the explanatory memorandum, it is reported that "[in] the almost five years after Law No. 2019-486 of May 22, 2019, (PACTE law) on the growth and transformation of businesses, this bill aims [...] to enable businesses to continue their development through the mobilization of capital from investors—French, European and international. To ensure they complete all stages of their development in France, companies must have access to financing conditions resembling those they could access in other major global financial centres."

Additionally, Section 1 of this proposed law "is intended to facilitate initial public offerings. It authorizes companies to go public by issuing preferred shares that give the right to several voting rights for one share [...] to give issuers the same options as those offered in many other financial markets."

The final version of the law was adopted and enacted on June 13, 2024. It confirms that "in the context of the first admission of a company's shares to trading on a regulated market or a multilateral trading facility, preferred shares with modified voting rights may be created," thereby opening the door to DCS structures for new IPOs.

Furthermore, the law imposes constraints, notably with respect to the maximum ratio, whereas "companies whose securities are admitted to trading on a multilateral trading facility, the ratio between the voting rights attached to a preferred share and those attached to a common share may not exceed 25:1 and must be a whole number of votes." This constraint does not apply to listings on a regulated market and is therefore essentially limited to smaller companies whose shares will be traded on venture exchanges.

In addition, the following restrictions apply:

- Automatic conversion clause (transfer of multiple voting shares is not allowed);
- Mandatory sunset clause (maximum 10 years from IPO), with the possibility of adding a further five years following a vote by subordinate shareholders at an extraordinary general meeting.

Summary

Entrepreneurs' interest in the stock markets is waning in favour of alternative sources of capital—all private—that enable them to secure the financing they want without the inconveniences of going public, and in some cases at a higher valuation.

The strong trend that began a decade or more ago, which has contributed to the decline in initial public offerings, is continuing. Canada is no exception.

Economies large and small around the world are looking for ways to make their capital markets more attractive, at least to their own local companies. The importance of capital markets to the health and robustness of the economy is undeniable, and governments are ready to make major changes to stimulate the growth of start-ups and thus foster innovation and productivity.

Elsewhere in the world, there is growing interest in structures that allow control to be maintained. This is no coincidence. In the text of the proposed directive of the European Parliament and the Council, it was pointed out that "multiple voting shares can protect a company against an excessive focus on short-term interests, by giving a stronger voice to founders and long-term shareholders." This assertion reflects the findings of numerous studies on the topic and echoes the historical position of IGOPP which, as early as 2006, took a position in favor of such structures with well-established guidelines. This position was renewed and strengthened in 2019 by the addition of analyzes and recommendations, in particular regarding the various restrictive clauses (sunset) often associated with DCS structures.

While many countries are seeking to introduce DCS structures to make their public markets more attractive, Canada already has all the tools it needs at its disposal. And yet, contrary to what is happening everywhere else, pressure is being exerted to abandon these valuable tools or to further restrict them by imposing constraints that are now considered arbitrary and for the most part without empirical support.

Canadian entrepreneurs who feel the need to maintain control over their company to achieve their long-term vision must choose the structure that is optimal for them. The argument for a one-size-fits-all shareholder structure must be abandoned. Every company is different and should be allowed to opt for the structure that best suits its strategic imperatives and long-term ambitions. It is always possible to abandon a dual-class share structure, but it is impossible to adopt one if this choice was not made initially. This is therefore a critical decision at the time of the IPO.

Apart from questions of shareholder structure, the statistics on the decline in the number of IPOs raise considerable issues. Given that more than a year has passed without an IPO by a conventional company in the main Canadian segment (TSX)—a period marked instead by issuers going private—it is essential to open the debate on this issue and find sustainable solutions to bolster the appeal of our stock markets to our entrepreneurs.

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About IGOPP

THE REFERENCE IN GOVERNANCE MATTERS

Created in 2005 by two academic institutions (HEC Montréal and Concordia University – The John Molson School of Business), Autorité des marchés financiers 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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- Assume intellectual leadership in the area of governance;
- 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, through media interventions, and by a wide dissemination of information and knowledge about governance.

OUR ACTIVITIES

The Institute's activities focus on the four following areas:

- **Policy papers**
- **Training**
- **Research**
- **Knowledge dissemination**

Notes

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of private and public organizations

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