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# Dual class firms: Capitalization, ownership structure and recapitalization back into single class

Ben Amoako-Adu \*, Brian F. Smith

*Clarica Financial Services Research Centre, School of Business and Economics,  
Wilfrid Laurier University, Waterloo, Ont., Canada N2L 3C5*

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## Abstract

This paper analyses changes in capitalization and control of dual class firms before and after IPO. The results indicate that the combination of a large controlling shareholder with family interests, rather than concentrated ownership per se, leads to dual class capitalization. During the first 15 years post-IPO, voting leverage continuously increases as the dual class firms issue more restricted than superior voting shares. However, control changes are equally frequent for dual and single class firms suggesting that dual class capitalization is not used to unduly entrench management. We document disputes between restricted and superior voting shareholders to illustrate the potential corporate governance problems which are associated with dual class capitalization. As a result of these disputes, investor interest in dual class equity has decreased and there is a recent trend toward reclassification back into single class equity. © 2001 Elsevier Science B.V. All rights reserved.

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\* Corresponding author. Tel.: +1-519-884-0710, ext. 2327; fax: +1-519-884-0201.  
*E-mail address:* bamoako@wlu.ca (B. Amoako-Adu).

## 1. Introduction

Despite the optimality conditions of one-share-one-vote highlighted by Grossman and Hart (1988) as being necessary for the maximization of shareholder benefits, a large number of corporations recapitalize their common equity into two classes based on unequal voting rights. DeAngelo and Rice (1983), Jarrell and Poulsen (1988), Lehn et al. (1990), and Moyer et al. (1992) discuss how dual class capitalization is used as an alternative monitoring mechanism to prevent unwanted takeover. DeAngelo and DeAngelo (1985) and Bergström and Rydqvist (1990) show that companies controlled by a small group of shareholders, usually related by family, are the most likely firms to adopt dual class equity. The question arises as to whether such shareholders do this in order to unduly entrench themselves or whether they are open to takeover but adopt dual class capitalization in order to better negotiate the terms of sale. The latter reason is consistent with Zingales (1995) who proposes a model in which an owner may take his company public as an alternative means of divesting his interest in the firm. Thus, dual class shares can serve as a means to control the timing as opposed to eliminating the possibility of a takeover. In addition, Burkart et al. (1998) demonstrate that dual class capitalization may be optimal in that it intensifies competition among bidders for control of the firm since it leads to higher bid prices and more shares tendered.<sup>1</sup>

These arguments per se may not fully explain the motive behind dual class capitalization because concentrated ownership in a single class firm can be used to maintain control within a coalition of shareholders and prevent hostile takeover. In addition, despite the fact that the firms originally adopted this anti-takeover mechanism, some dual class companies voluntarily recapitalize the two classes of equity back into a single class. Furthermore, the evidence in Comment and Schwert (1995) indicates that the more frequent adoption of anti-takeover mechanisms in recent years has not discouraged takeover activities. Rather, the adoption of such anti-takeover measures increased takeover premiums.

In this paper, we apply the term restricted share to three types of common shares listed on the Toronto Stock Exchange (TSE). These are non-voting shares, subordinate voting shares and restricted voting shares. Non-voting shares carry no votes. Subordinate voting shares carry one vote per share while the other class of common equity of the firm carries multiple votes per share.

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<sup>1</sup> This argument is related to that of Harris and Raviv (1988) that capital structure generally and debt, in particular, affect firm value by serving as a takeover defense. Leverage like dual capitalization increases voting control by the incumbent and reduces the probability of the incumbent being voted out.

Restricted voting shares carry a vote, as does the other class of common equity, but are limited as a class to electing a minority of the board of directors. The term superior voting shares applies to the class of equity which either carries greater voting rights per share or else is unrestricted in being able to vote for a majority of directors.

To examine the motives for dual class capitalization, we conduct a longitudinal study of dual class firms as opposed to examining only single events like IPOs or takeovers in isolation as almost all previous studies have done. The one exception is Fields (1999) who documents that during the first five years following IPO, acquisition of the firm is as equally likely for companies with single and dual class equity. Tracking firms over a 15-year period and following most of them from IPO through to reclassification back into a single class allows us to address the following questions: Building on the research of Lehn et al. (1990) and Taylor and Whitted (1998), what are the characteristics of firms that choose dual class structure relative to single class structure? If the purpose of dual class capitalization is to preserve control, does the control of dual class firms post-IPO actually change less frequently than for single class firms? On this question, we extend the work of Fields (1999) by considering both the five and 10-year periods following IPO. For those firms that maintain a dual class structure, to what extent are there greater issues of restricted than superior voting shares and thus, continually increasing voting leverage subsequent to the IPO? Do the reasons for subsequent issues of restricted and superior voting shares differ? Do corporate governance problems emerge in the years following IPO? How frequently do dual class firms reclassify back into a single class and what are the reasons behind the consolidation?

This study uses Canadian data to provide insights into the above stated questions for a couple of reasons. First, the TSE has had a long history with dual class firms which dates back to 1925 when Power Corporation first listed its restricted shares on the exchange. Over the period 1979–1998, an average of 13% of all listed stocks on the TSE had dual class capitalization. Second, in comparison to the dual class equity markets in the US, Australia, Britain and other European markets, there are relatively few legal restrictions on the dual class capitalization of firms in this market. These two aspects of the TSE provide a large sample of dual class firms that can be tracked for up to 15 years following IPO in a relatively static regulatory environment.

The paper is organized into six sections. In Section 2, we discuss two closely related studies and show how our current study contributes to the literature. Since the issuing of dual class shares may be a function of the securities regulation in each country, the regulatory environment for dual class shares on the TSE is described in Section 3. In Section 4, the research methodology and data used in the analysis are presented and the empirical results and inferences are discussed in Section 5. Finally, the conclusions are presented in Section 6.

## 2. Related literature

Though there are many published studies on dual class capitalization, two related empirical papers which test for fundamental differences between dual class and single class companies are Lehn et al. (1990) and Taylor and Whittred (1998). In comparing the characteristics of 380 US listed firms from the 1977 to 1987, Lehn et al. (1990) find that firms with higher growth rates in sales, higher market-to-book ratios and lower tax liabilities are more likely to adopt a dual class capitalization instead of using leverage buyout as a mechanism of corporate control. Their sample excludes IPOs and thus does not directly examine the majority of firms in countries, such as Canada, which adopt a dual class structure at the time of initial listing.

In an Australian study, Taylor and Whittred (1998) analyse the IPO prospectuses of 53 dual class companies and compare their characteristics with single class firms. They find that dual class firms are smaller, have lower financial leverage ratio and are controlled by the founders. They also indicate that 80% of the dual class firms use a “coattail” provision to ensure equal treatment of all shareholders during takeover.<sup>2</sup> They conclude that the value of the dual class firms are highly dependent on the management capabilities of the founders and not on the company’s assets per se.

In developing tests to explain which firms adopt dual class equity, it is important to identify which factors are related to likelihood of hostile takeover. Palepu (1986), Morck et al. (1988), Mikkelsen and Partch (1989) and Comment and Schwert (1995) find that size deters hostile takeovers. As Comment and Schwert (1995) note, size is the only consistent variable which is significantly related to the likelihood of hostile takeover. Thus, given that dual class equity is adopted to deter hostile takeover, size should be included as an explanatory variable in our analysis.

As an extension to the above cited papers, we use comprehensive TSE data on dual class and single class IPOs to reexamine the question of what motivates firms to adopt dual class capitalization. Our research differs from the above cited studies on several dimensions. First, the paper considers the dilution effects on control of firms up to 15 years subsequent to IPO. It examines whether post-IPO changes of control, equity issuances and reclassifications back into a single class are consistent with the goal of preservation of control or with the adoption of a mechanism to affect the timing and conditions of sale of control. Second, it provides evidence on the corporate governance problems between superior voting and restricted shares that arise in the years following dual class

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<sup>2</sup> “Coattail” is a company’s provision which is meant to provide equal treatment to all classes of shareholders upon a takeover involving an acquisition of at least 50% of the superior voting shares of a dual class company.

IPO. Third, the paper provides additional evidence on family control and pyramid structures in dual class firms.

### **3. Regulatory environment for dual class shares**

The market for dual class shares in Canada has few regulations relative to other countries because apart from some TSE listing requirement for dual class shares and the guidelines with respect to the preparation of coattails, there are no specific Ontario Securities Act restrictions and regulations for dual class shares. Companies are generally free to structure and package the terms of their dual class shares to meet investor demand.

Since August 1987, it has been a TSE listing requirement that any company listing either one class or both classes of shares on the exchange should adopt a coattail. Table 1 shows that the percentage of TSE listed dual class firms with a coattail increased from 78.53% in 1988 to 88.51% in 1998. Since some listed companies had no coattail prior to the 1987 requirement and the requirement was not made retroactive, not all dual class listed companies had coattails as of 1998. It should be noted that the coattail is only a TSE listing requirement and is not required by securities law. In addition, despite the coattail requirement, there is an “exempt” offer provision (Section 92 (1)(c) of the Ontario Securities Act and Regulation), which allows investors to buy as many of the shares of the company without extending the offer to all shareholders provided purchases are made from not more than five sellers and the offer price does not exceed 115% of the pre-offer market price. This means a change of control could occur without triggering the coattail if an exempt offer is used.

The coattail requirement may have implications for the screening theory of Grossman and Hart (1988), and the monitoring theory of Burkart et al. (1997, 1998). Grossman and Hart (1988) argue that a bidder will pay a higher price for the superior voting shares than the restricted shares to acquire private benefits of control. However, a “coattail provision” requires a bidder to pay equal benefits to all security holders and the controlling party in a takeover contest. This corresponds to the case of one-share-one-vote in which benefits to all security holders are generally maximized relative to benefits to the controlling party.

Burkart et al. (1998) argue that bidders prefer to gain control by acquiring superior voting shares as they only need to pay for a small stake of the firm and they can then be in a position to extract private benefits. A coattail provision requires the bidder to make an offer to acquire equal proportions of shares of both classes. Thus, with a coattail provision, a bidder internalizes a larger part of the inefficiency associated with the extraction of private benefits and moral hazard is lessened. However, dual class firms with coattail provisions are more costly to acquire. Burkart et al. (1998) note that the higher cost of acquisition

Table 1  
 Characteristics of dual class firms listed on TSE<sup>a</sup>

Year	1988	1993	1998
Total number of firms	177	164	148
Non-voting	80 (45.20%)	67 (40.85%)	57 (38.51%)
Subordinate voting			
Ratio $x \leq 10 : 1$	62 (35.03%)	64 (39.02%)	61 (41.22%)
Ratio $10 : 1 < x$	26 (14.69%)	24 (14.63%)	22 (14.86%)
Restricted voting	9 (5.08%)	9 (5.49%)	8 (5.41%)
Policy of equal dividends	61.88%	66.23%	66.92%
Coattail provision	78.53%	84.76%	88.51%
Minimum percentage of equity required to hold 50% voting control	18.62%	16.25%	15.22%

<sup>a</sup>This table shows the number (percentage) of firms that are non-voting, subordinate voting and restricted voting. The table breaks down subordinate voting shares into categories based on ratio of number of votes per share ( $x$ ) associated with multiple voting versus single voting shares. Restricted voting shares place other types of restrictions on the voting rights of one class of equity. For example, the restricted voting shares as a class may elect only 30% of the board of directors, independent of the relative number of each class of share outstanding. A policy of equal dividends means that the restricted and superior voting shares are entitled to the same dividend. In the remaining percentage of cases, the restricted shares are entitled to a preferential dividend. Coattail provisions require that the same offer be made to all holders of restricted shares where a takeover offer is made to all holders of superior voting shares. The minimum percentage of equity required to hold 50% voting control is calculated as in Bergström and Rydqvist (1990).

will lessen the likelihood of takeovers. Thus, a coattail provision may not be optimal in all cases.

Burkart et al. (1997) discuss the monitoring role played by large shareholders. Since ownership concentration and monitoring of management actions are facilitated through the acquisition of superior voting shares, the adoption of a coattail effectively nullifies the exclusive monitoring efforts of the holders of superior voting shares because the two classes of shareholders will have equal voting rights upon a change of control.

Unlike the voting ratio restrictions in Sweden, Finland and Denmark, as reported in Bergström and Rydqvist (1990), Rydqvist (1992) and Teall (1997), Canadian dual class companies are not required by law to observe any maximum voting ratio between superior voting and restricted shares. As reported in Table 1, non-voting shares comprised the largest proportion of dual class shares in 1988 and 1993. The second largest category of voting ratio in those years and the largest in 1998 consisted of voting ratios where a superior voting share has 10 or fewer votes and one subordinate share has one vote. The largest

unequal voting ratio is reported by Magna International where one superior voting share carries 500 votes and one restricted share has one vote.

The relatively permissive legal environment for dual class shares in Canada is consistent with the strong presence of publicly listed family controlled companies in Canada. Morck and Strangeland (1994) indicate that in a sample of 180 of Canada's largest companies, 38% of the firms had founders or their heirs holding over 20% of the votes. Despite the integration of the US and Canadian economies, US firms tend to be more widely held. Explanations for the greater frequency of publicly listed family firms in Canada versus the US include Canada's lower estate taxes which allow intergenerational transfer of corporate control to heirs with minimal tax consequences. The high level of US estate taxes is discussed in Slovin and Sushka (1993). In Ontario, the province in which most of the companies in our sample are headquartered, probate fees are only approximately 1.5% of the estate's value. Furthermore, under the Canadian Income Tax Act, there are a number of exemptions allowed that can reduce or defer capital gains at death. In addition, Morck and Strangeland (1994) note that Canada has a weaker trust busting policy than the US and that a number of family controlled firms have been allowed to grow and take a large market share of their industry in Canada.

Table 1 shows that the market for dual class shares has evolved even when regulatory changes were few. For example, there does appear to be a trend toward greater votes per restricted share. The percentage of non-voting shares declined from 45.20% in 1988 to 38.51% in 1998. The proportion of dual class firms with equal dividend treatment between superior voting and restricted shares increased from 61.88% in 1988 to 66.92% in 1998. The latter percentage is consistent with US dual class firms reported in Böhmer et al. (1996). Finally, Table 1 shows that the average minimum percentage of equity required to hold a 50% voting interest in these firms decreased from 18.62% in 1988 to 15.22% in 1998. The changes in this measure of voting leverage which was developed in Bergström and Rydqvist (1990) indicate an increasing concentration of control among these firms.

## **4. Methodology and data**

### *4.1. Methodology*

To examine the factors that underlie the choice between dual and single class equity structure at the time of IPO, a logit model is constructed and tested on a sample of 62 dual and 318 single class firms that went public between 1983 and 1998. The dependent variable has a value of one if the IPO involves dual class equity and zero otherwise. All the explanatory variables are identified from the literature and theory except the control binary variables, comprising post-1987,

previous use of dual class shares, and the industry classifications. The logit regression model is expressed as follows:

$$\begin{aligned} \ln(p_j/(1-p_j)) = & \alpha_0 + \alpha_1(\text{votes of largest shareholder})_j \\ & + \alpha_2(\text{family firm})_j + \alpha_3(\text{size})_j + \alpha_4(\text{age of firm})_j \\ & + \alpha_5(\text{previous use of dual class shares})_j \\ & + \alpha_6(\text{post-1987})_j + \alpha_7(D_1)_j + \alpha_8(D_2)_j + \alpha_9(D_3)_j + e_j, \end{aligned} \quad (1)$$

where,  $p_j$  is the probability of a dual class IPO for firm  $j$ ,  $D_1$  the Industrial and Consumer Products Dummy Variable which assumes the value of one if the firm belongs to the industrial and consumer products sector and zero otherwise,  $D_2$  the Merchandising and Distribution Dummy Variable with a value of one if the firm belongs to the merchandising sector and zero otherwise,  $D_3$  is the Technology Dummy Variable with a value of one if the firm belongs to the technology sector and zero otherwise.

**Votes of largest shareholder** – It is expected that shareholders with more votes are more likely to be interested in preserving control upon IPO than other shareholders. Burkart et al. (1997) argue that large shareholders seek control to be in a position to select preferred projects. DeAngelo and DeAngelo (1985), Bergström and Rydqvist (1990), and Megginson (1990) provide empirical support that voting shares provide both control and private benefits to controlling shareholders. To the extent that large shareholders demonstrate a strong preference for control prior to the firm going public, it is expected that such a preference will persist after the IPO. Thus, a large voting block prior to IPO is expected to be positively related to dual class adoption.

**Family firm** – If a firm's largest shareholder is an individual or a group related by family ties then this dummy variable has a value of one. Otherwise the value of the variable is zero. There is substantial evidence that dual class firms tend to be family controlled for reasons such as employing family members in positions of senior management and having the option of passing on control to the next generation. Thus, the control benefits that dual class equity serves to protect are fairly pronounced in family firms. Smith and Amoako-Adu (1999) find that family controlled firms are more likely to adopt dual class capitalization.

**(Family firm) × (votes of largest shareholder)** – This compound variable is used as an alternative to the family firm and voting block variables included separately. That is, it is the combination of a controlling family shareholder with a high voting interest that is most consistent with the desire to maintain control through the choice of dual class shares.

**Size as measured as assets in \$ billions** – Previous research findings are mixed as to whether firms with dual class IPOs are larger than single class firms



going public. Palepu (1986), Morck et al. (1988), Mikkelson and Partch (1989) and Comment and Schwert (1995) find that large size deters hostile takeovers. Thus, as a takeover defence, dual class capitalization may be more important for smaller firms. Consistent with this argument, Taylor and Whittred (1998) report that in Australia, dual class IPO companies tend to be smaller than their single class counterparts. On the other hand, Böhmer et al. (1996) find that a sample of 66 NASDAQ dual class firms going public are significantly larger than a control sample of single class firms.

**Age of firm** – The age of the firm is the number of years from incorporation to IPO. Burkart et al. (1997) and Taylor and Whittred (1998) argue that the motivation to adopt dual class equity is to protect the firm-specific investment in human capital of the controlling shareholder/manager. In particular, Burkart et al. (1997) argue that there is a “control effect” whereby a shareholder wants to maintain close control of a firm in order to undertake preferred projects. The preference will be stronger where a controlling family wants to preserve its firm-specific investment in human capital.<sup>3</sup> We use the age of the firm as a proxy for investment in human capital on the assumption that before going public, the largest shareholder is a founder and has been with the firm since its incorporation. Consequently, age of firm should be positively related to likelihood of dual class adoption.

**Previous use of dual class shares** – this dummy variable has a value of one if the firm’s largest shareholder was a controlling shareholder of a previously listed dual class firm. This is a control variable to indicate the effect of the major shareholder’s familiarity with dual class capitalization. A past decision to use dual class equity structure would likely be repeated given the controlling shareholder’s demonstrated interest in preserving control. In addition, if a shareholder controls one company through dual class equity and in turn, that firm controls another company through dual class equity, voting power is leveraged. Nicodano (1998) describes the multiplier effect of pyramiding and restricted shares in the Italian market.

**Post-1987** – This is a binary variable included to control for a possible shift in the supply of dual class IPOs following the Canadian Tire takeover controversy which is discussed in Section 5.3 of the paper. Smith and Amoako-Adu (1995) find a significant increase in the price premium of superior voting shares over their restricted counterparts after 1987. They attribute the rise in the price premium to the controversy surrounding the attempted takeover of Canadian Tire Corporation and the uncertainty created over the efficacy of

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<sup>3</sup> Burkart et al. (1997) argue that the “initiative effect” counteracts the “control effect” described above. The close control of a firm has monitoring costs which result from stifling of managerial initiative. This effect may not be relevant in assessing the impact of the age of the firm on the decision to choose dual versus single class capitalization.

coattail provisions. A rise in the price premium means that firms will receive less from investors when issuing restricted shares. Thus, there are expected to be fewer dual class IPOs after 1987.

Industry variables  $D_1$ ,  $D_2$  and  $D_3$  – The three industry classification variables are included primarily as control variables. Taylor and Whittred (1998) find that Australian firms in the food and household sector more frequently use dual class equity than firms in other industries. In addition, Taylor and Whittred (1998) report that dual class firms are more likely to have a higher proportion of their value related to growth opportunities than assets-in-place. On this basis, technology firms with expected rates of growth higher than other industries should be more likely to adopt dual class shares.

Based on the above discussion, all of the coefficients except those for asset size and the post-1987 variable are expected to be positive. The logit regression is estimated in three different forms to test the separate and combined effects of the largest shareholder vote ownership and family firm variables.

#### *4.2. Data and characteristics*

All dual class firms that had shares listed on the TSE over the period January 1979–December 1998 were identified from monthly issues of the TSE Review. As shown in Table 2, the number of dual class firms increased from 60 at the beginning of 1979 to 177 at the end of 1988. Thereafter, the number dropped to 148 as of the end of 1998. As a percentage of all firms listed on the TSE, the recent decline is even more rapid. In Fig. 1, from 8.6% at the end of 1979, the percentage rose to a peak of 16.7% at the end of 1986 and fell to 10.2% at the end of 1998. As discussed later in the paper, this decline is consistent with lobbying against dual class shares by institutional activists after the 1987 Canadian Tire controversy that highlighted problems that can arise with restricted shares. The decline in Canada in the use of dual class equity is similar to the recent decrease in their usage in Switzerland documented in Kunz and Angel (1999).

Before 1989, 66 out of 175 dual class firms were listed as a result of reclassification of the shares of a publicly traded firm with single class equity. Thereafter, the preferred route, by a wider margin, was through IPOs. Only 16 out of 94 firms were listed as dual class firms as a result of reclassification after 1988. This trend is likely a response to the criticism of dual class shares that has focused on reclassifications that induce approval by offering shareholders that accept restricted shares preferential dividend treatment.

While the objective of the dual class equity structure is to preserve control, it is surprising how many firms experience a change of control. Over the period 1979–1998, of the 329 dual class firms listed at some time during the period, 181 (55%) were delisted by the end of 1998. Ninety firms were taken over and delisted, 56 firms reclassified their equity back into a single class and 35 firms

Table 2  
Changes in number of dual class firms listed on TSE<sup>a</sup>

Period	1979–1988	1989–1998	Total 1979–1998
Number of initial public offerings with dual class shares	109	78	187
Number of reclassifications from single to dual class equity	66	16	82
Total new listings	175	94	269
Number of complete takeovers	33	57	90
Number of reclassifications from dual to single class equity	17	39	56
Number of dual class listings removed for other reasons, including financial distress	8	27	35
Total decrease in listings of dual class firms	58	123	181
Net increase (decrease) in dual class listings	117	(29)	88
Number of dual class firms			
Beginning of period	60	177	60
End of period	177	148	148

<sup>a</sup>This table shows the composition of changes in the number of dual class firms listed on the Toronto Stock Exchange over the period 1979–1998 and over the sub-periods, 1979–1988 and 1989–1998.

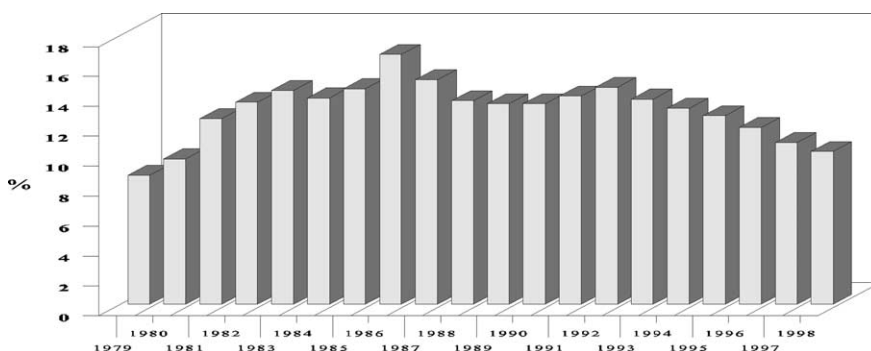


Fig. 1. Dual class firms as a percentage of all firms listed on the TSE from 1979 to 1998.

delisted because of financial distress. Also, of the 60 dual class firms listed at the beginning of 1979, only about one-third were listed at the end of 1998. Thus, the use of dual class shares to preserve control for intergenerational transfer appears to be more of the exception than the rule.

The sample used in the logit analysis includes all dual and single class firms that went public over the period 1983–1998 on the TSE with the exception of companies in the natural resource, communications, airline, utility, and financial services sectors. Firms in these industries are excluded as there are income tax incentives and regulatory restrictions to promote Canadian control which is facilitated through the use of dual class shares. In addition, since copies of prospectuses prior to 1983 were not available to us, the analysis was started in 1983. A total of 62 and 318 dual and single class firms, respectively, were obtained.

Table 3 indicates that the distribution across industries is different between dual and single class firms. Contrary to what we expected based on Taylor and Whittred (1998), the most notable difference is that IPOs of technology firms have been predominately single class equity. Of 104 technology firms, only one had a dual class equity structure. Dual class firms are much more concentrated among the industrial and consumer products, merchandising and the distribution sectors.

Table 4 examines whether the characteristics of dual and single class IPOs significantly differ. Dual class firms are almost 50% older than single class firms, i.e., on average 13.55 versus 9.31 years. This is consistent with longer-term investment in the human capital of the controlling shareholder in the case of dual class firms. In contrast to the sample of Australian IPOs in Taylor and Whittred (1998), the dual class firms going public on the TSE are found to be significantly larger by asset size than single class firms. We attribute the dif-

Table 3  
Industry classification of IPOs from 1983 to 1998<sup>a</sup>

	Dual class	Single class	Difference
Industrial and consumer products	37 (59.68%)	146 (45.91%)	13.77% (1.98)*
Technology	1 (1.61%)	103 (32.39%)	-30.78% (-4.97)***
Merchandising and distribution	20 (32.26%)	53 (16.67%)	15.59% (2.85)***
Real estate	1 (1.61%)	12 (3.77%)	-2.16% (-0.86)
Conglomerates	3 (4.84%)	4 (1.26%)	3.58% (1.92)
Total	62 (100.00%)	318 (100.00%)	n.a.

<sup>a</sup> This table shows the industry classification of firms that went public over the period 1983–1998 on the TSE. Firms in the natural resource, communications, airline and financial services sectors as well as utilities are excluded as there are income tax and regulatory incentives to maintain Canadian control which is facilitated through the use of dual class shares. The figures in parentheses in the second and third columns are the percentages of the column total. The figures in parentheses in the fourth column are z-statistics. \* and \*\*\* indicate significance at the 10% and 1% levels, respectively.

Table 4  
Descriptive statistics of dual and single class IPOs on the TSE between 1983 and 1998<sup>a</sup>

Firm characteristics	62 Dual class firms	318 Single class firms	Difference
Age of firm (years since incorporation)	13.55 (16.11) 7.00	9.31 (12.19) 6.00	4.24 (2.36)**
Asset size (in \$millions)	176.6 (267.7) 44.7	79.0 (260.2) 20.1	97.6 (2.69)***
Vote ownership by largest shareholder immediately before IPO	69.89% (26.20%) 72.85%	54.42% (30.76%) 50.55%	15.47% (3.71)***
Vote ownership by largest shareholder immediately after IPO	64.58% (24.62%) 65.79%	36.47% (23.42%) 35.00%	28.11% (8.57)***
Equity ownership by largest shareholder immediately after IPO	42.35% (23.95%) 38.95	36.47% (23.42%) 35.00%	5.88% (1.80)*
Number (%) of firms where largest shareholder is individual or family	50 (80.65%)	193 (60.69%)	19.96% <sup>b</sup> (2.99)***
Number (%) of firms with related companies that previously issued dual class equity	9 (14.52%)	5 (1.57%)	12.95% <sup>b</sup> (4.95)***
Percentage of management related by family to largest shareholder	22.60% (20.49%) 20.00%	17.90% (21.16%) 13.39%	4.70% (1.61)
Percentage of directors related by family to largest shareholder	24.03% (19.23%) 20.00%	18.35% (16.88%) 16.67%	5.68% (2.37)**
Number (%) of firms which adopted poison pills	0 (0.00%)	19 (5.97%)	n.a.

<sup>a</sup> This table shows the descriptive statistics of 380 firms which went public on the TSE between 1983 and 1998. Excluded are firms in industries that are affected by legislation promoting control by Canadians. These industries are natural resources, communications, airlines, utilities, and financial services. The top, middle and bottom figures in each cell in columns two and three are the mean, standard deviation and median, respectively. With the exception of the cell discussed in note b, the fourth column reports difference in means and the *t*-statistics of this difference (in parentheses). Statistics with \*, \*\* and \*\*\* are significant at the 10%, 5% and 1% levels, respectively.

<sup>b</sup> The first figure in these cells shows the difference between the percentage of dual and single class firms which have this characteristic. The second figure in brackets is the *z*-statistic for the difference in percentages.

ference to the fact that technology firms tend to be smaller in terms of asset size and unlike our sample, 44% and 26% of Australian dual and single class firms, respectively, were involved in technology. Our results are consistent with those of Böhmer et al. (1996) who find in the US that a sample of 66 NASDAQ dual class firms are significantly larger and older than a control sample of single class firms.

Before going public, the largest shareholder of both dual and single class firms controls a majority of votes. Following the IPO, the percentage of votes controlled by the largest shareholder of dual class firms decreases from 69.89% to 64.58% whereas in single class firms the percentage of votes decreases from 54.42% to 36.47%.<sup>4</sup> This is consistent with the goal of establishing a dual class structure in order to access outside equity without diluting control.

Dual class capitalization is one of a number of anti-takeover mechanisms that a company can employ. An extensive search for newspaper articles citing adoption of an anti-takeover mechanism by TSE-listed firms indicated that poison pills, also known as shareholder's rights plans, were the most popular anti-takeover device other than dual class capitalization. Dual class capitalization and poison pills tend not to be used simultaneously. None of the 62 dual class IPOs had subsequently adopted a poison pill whereas 6% of single class firms had. Thus, controlling shareholders of many Canadian firms appear to have a strong preference for dual class capitalization as an anti-takeover defence.

Consistent with evidence reported in DeAngelo and DeAngelo (1985), dual class firms are much more likely to have a controlling shareholder that is an individual or family. Over 80% of dual class firms have such shareholders versus 60% for single class firms. The significantly larger percentage of directors related by family to the largest shareholder is also indicative of family influence. The percentage of management related by family to the largest shareholder is also larger in the case of dual class firms but the difference is not statistically significant. Table 4 also indicates that 14.52% of dual class firms had a controlling shareholder who already owned another dual class firm whereas only 1.57% of single class firms had this type of controlling shareholder. This suggests that in Canada, as in continental Europe as documented in Nicodano (1998), there is a tendency for some firms to expand through a combination of pyramiding and dual class structure. In addition, the finding that the controlling shareholder in dual class firms owns an average of 42.35% of the equity and well over 50% of the votes after the IPO supports the finding of Bergström and Rydqvist (1990) that controlling shareholders own more equity than necessary to control a firm.

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<sup>4</sup> The post-IPO voting interests of founders of dual and single class shares approximate those reported in Taylor and Whittred (1998).

## 5. Results

### 5.1. *Logit analysis*

Table 5 presents the results of the logit analysis of the choice between dual versus single class equity. Consistent with the analysis of mean differences, the coefficients of the variables for votes of largest shareholder, family firm and previous use of dual class shares are positive and statistically significant. The positive impact of the largest shareholder in the IPO indicates that, consistent with theory, a controlling shareholder would like to use an IPO to create a dual class structure to maintain corporate control and simultaneously have access to the equity market. Similarly, the positive coefficient of the family firm variable indicates that family controlled firms have higher propensity to go public with dual class capitalization. In models 2 and 3, where the product of vote ownership of the largest shareholder and family firm is included as an explanatory variable, the positive coefficient indicates that it is the combination of concentrated votes and family ownership which may induce a dual class capitalization and not the presence of either the largest shareholder or family ownership per se. Size, measured as the assets of the firm, is not consistently significant as a determinant when a firm decides to adopt a dual class capitalization.

As shown in Table 5, the coefficient for the age of the firm is positive but not statistically significant. Furthermore, as expected, the coefficient of the post-1987 variable is significantly negative. This indicates that after the controversial attempted takeover of Canadian Tire in 1987, firms were less interested in going public with dual class equity. The negative coefficient on the technology variable is significant at the 5% level. This indicates that technology firms are unlikely to adopt dual class capitalization when going public. Although not significant, the positive sign on the industrial and consumer products and merchandising and distribution variables provides further evidence that dual class capitalization is more likely for these industries.

### 5.2. *Time series of post-IPO ownership changes and dilution effects*

Table 6 shows the subsequent changes in control following dual and single class IPOs. If the primary goal of dual class shares is to preserve control, one should expect to see that the controlling shareholders of dual class firms at the time of IPO hold their voting position longer than in the case of single class firms. On the other hand, if as Zingales (1995) suggests, IPOs serve as a mechanism for an owner to divest his interest in the firm, then dual class capitalization may just be a means to control the timing of his ultimate divestment, rather than be used to inhibit control changes. We find evidence to support this latter argument. While the controlling shareholders of dual class

Table 5  
Logit analysis of IPO choice of dual versus single class equity<sup>a</sup>

Variables		Model 1	Model 2	Model 3
	Constant	-2.74 (-3.22)*** [-1.76]	-1.90 (-2.41)** [-1.22]	-1.94 (-2.47)** [-1.24]
Theory variables	Vote ownership of largest shareholder	0.01 (2.10)** [0.51]	0.00 (0.29) [0.08]	
	Family firm	1.11 (2.86)** [0.55]		0.27 (0.46) [0.13]
	Family firm × vote ownership of largest shareholder		0.01 (2.69)*** [0.44]	0.01 (1.86)* [0.39]
	Size measured as assets in \$ billions	0.84 (1.66)* [0.08]	0.75 (1.51) [0.07]	0.79 (1.59) [0.07]
	Age of firm	0.01 (1.18) [0.09]	0.01 (1.13) [0.09]	0.01 (1.23) [0.10]
	Control variables	Previous use of dual class shares	1.73 (2.72)*** [0.08]	1.77 (2.81)*** [0.08]
	Post-1987 (After Canadian Tire Conflict)	-1.29 (-3.86)*** [-0.31]	-1.32 (-3.94)*** [-0.32]	-1.33 (-3.98)*** [-0.32]
	Industrial and consumer products, $D_1$	0.01 (0.01) [0.00]	0.02 (0.03) [0.01]	0.04 (0.06) [0.02]
	Merchandising and distribution, $D_2$	0.48 (0.63) [0.09]	0.50 (0.66) [0.10]	0.52 (0.69) [0.10]
	Technology, $D_3$	-2.60 (-2.17)** [-0.04]	-2.59 (-2.16)** [-0.14]	-2.59 (-2.15)** [0.04]
	Number of firms	380	380	380

<sup>a</sup> This table shows the results of a logit analysis of a sample of dual and single class IPOs over the period 1983–1998. The dependent variable is one (zero) for IPO of dual (single) class firms. Voting block of largest shareholder is the largest proportion of total votes held by any single shareholder or group of shareholders related by family ties. A family firm is one in which an individual or family group is the largest shareholder. Age of firm is number of years from incorporation to IPO. Previous use of dual class shares carries a value of one if firm's owner was controlling shareholder of a previously listed dual class firm. The industry classification variables, Industrial and Consumer Products, Merchandising and Distribution, and Technology, have a value of one if firm belongs to respective industry. *T*-statistics are shown in round parentheses. \*, \*\* and \*\*\* indicate significance at the 10%, 5% and 1% levels, respectively. In order to translate the coefficients into marginal probabilities, the weighted aggregate elasticities were calculated, following Hensher and Johnson (1981) and are shown in square brackets. The logit regression is estimated in three different forms to test the separate and combined effects of the largest shareholder vote ownership and family firm variables.



Table 6  
 Subsequent change in control five and 10 years following dual and single class IPOs<sup>a</sup>

	Total	Same largest voting shareholder	Change in largest voting shareholder	Became widely held	Acquired and delisted	Became financially distressed and delisted	Insufficient information available
<i>Panel A: Changes in control five years after IPO</i>							
Dual class	51 (100%)	28 (55%)	12 (23%)	3 (6%)	5 (10%)	1 (2%)	2 (4%)
Single class	184 (100%)	87 (47%)	34 (18%)	22 (12%)	24 (13%)	12 (7%)	5 (3%)
<i>Panel B: Changes in control 10 years after IPO</i>							
Dual class	43 (100%)	15 (35%)	8 (19%)	3 (7%)	10 (23%)	4 (9%)	3 (7%)
Single class	112 (100%)	28 (25%)	17 (15%)	10 (9%)	38 (34%)	13 (12%)	6 (5%)

<sup>a</sup> Panels A and B of Table 6 document the changes in control over the five- and 10-year periods, respectively, following IPO. Panel A includes all IPOs which occurred between 1983 and 1993 and Panel B includes all IPOs between 1983 and 1988. The largest voting shareholder must hold at least 20% of the votes of the firm. Where no shareholder or group of shareholders related by family owns at least 20% of the votes, the firm is considered widely held. The results from the z-statistics for test of difference in proportions across dual and single class firms indicate no significant difference at even the 10% level.

shares tend to be more stable than shareholders in single class firms, the difference is not significant. After five years, 55% and 47% of the pre-IPO largest shareholders in dual compared to single class firms, respectively, are still in control. This result is consistent with Fields (1999) who finds that in the five-year period following IPO, there is a smaller likelihood of acquisition of dual than single class firms but the difference is not statistically significant. After ten years, the figures decrease to 35% and 25%, respectively. The slightly longer tenure of the dual class controlling shareholders is consistent with Smith and Amoako-Adu (1999) who find that approximately two-thirds of firms with a family member management successor are dual class firms. Most dual class firms however experience a change of control in terms of the largest shareholder, become widely held, are completely acquired or become financially distressed. Thus, the use of dual class equity gives controlling shareholders an option to maintain control but these shareholders do not exercise the option to control the firm much longer than those involved with single class firms.

Fig. 2 shows the average minimum percentage of equity that one needs to acquire to hold a 50% voting interest in these dual class firms over the first 15 years following IPO or reclassification from single to dual class equity. While previous tables indicate that many dual class firms reclassify back into a single

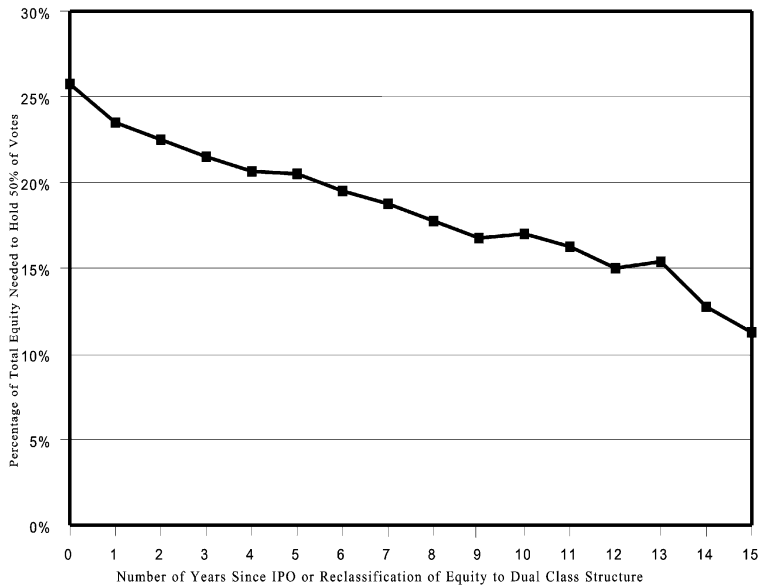


Fig. 2. Average percentage of equity required for control of dual class firms over 15 years subsequent to IPO/reclassification.

*Note:* This figure shows the average minimum percentage of equity that one needs to own to hold 50% of votes in dual class firms. The minimum percentage of equity is achieved by owning a sufficient number of superior voting shares. Bergström and Rydqvist (1990) develop this measure. The average percentage is calculated as the cross-sectional mean of the total sample of dual class firms that have data available each year following initial listing of restricted shares with an IPO or reclassification. The number of available firms decreases from 95 at time of initial issuance to 23 firms 15 years later.

class structure, those firms that retain their dual class equity structure dilute the equity position of restricted shares versus that of superior voting shares over time. The average minimum percentage of equity required to hold a 50% voting interest decreases from 25.75% to 11.25%. Thus, the voting leverage of superior voting shares greatly increases for those firms that maintain a dual class structure. The finding that the voting leverage steadily increases over a 15-year period extends the finding of Partch (1987) that 38.6% of US dual class firms issue restricted shares or debt/preferred stock convertible into restricted shares in the two years immediately following the creation of dual class structure.

While the pattern of Fig. 2 is attributable to greater numbers of restricted shares being issued than superior voting shares, it is necessary to examine the reasons why each class of equity is issued subsequent to initial listing. Table 7 documents the reasons why dual class firms issued restricted and superior voting shares subsequent to an IPO or reclassification from single to dual class equity over the period 1979–1998. As shown in Table 7, an average of 36.51%

Table 7  
Reasons for subsequent issues of dual class shares after initial listing<sup>a</sup>

Reasons for subsequent issuance of shares of dual class firms after IPO/reclassification	Average percentage of restricted shares issued for this reason (%)	Average percentage of superior voting shares issued for this reason (%)
Seasoned offering	36.51	17.04
Exchange of superior voting for restricted class	15.40	n.a.
Exercise of warrants or employee stock options <sup>b</sup>	11.85	33.72
Share exchange takeover offer	11.66	21.09
Conversion of convertible preferred stock	7.45	7.63
Conversion of convertible bond	5.14	2.81
Issued to employees at discount	3.09	7.19
Exercise of rights	2.38	3.04
Issued in payment of some debt	1.43	1.41
Other reasons	5.09	6.07
Total	100.00	100.00

<sup>a</sup>The first column of Table 7 shows the various reasons why restricted and superior voting shares are issued following IPO or reclassification from single to dual class equity. The second (third) column shows the average percentage of restricted shares (superior voting shares) issued for each reason subsequent to IPO or reclassification. The figures in the second and third columns are based on the average percentage across all dual class firms which issued such shares subsequent to IPO or reclassification over the period 1979–1998. The figures exclude stock issued as a result of stock splits, stock dividends and dividend reinvestment plans.

<sup>b</sup>The information used for computing these figures was provided by The Financial Post Company. This data source did not distinguish warrants from employee stock options.

of the restricted shares issued following initial listing are for seasoned offerings versus only 17.04% of the superior voting shares. This suggests that the dual class firms dilute equity but not control with seasoned offerings. Most superior voting shares are exchangeable for restricted shares at the option of the holder. This is a valuable option where only the restricted shares are publicly traded or in cases where the superior voting shares are publicly traded, but the market for these shares is illiquid. An average of 15.4% of the restricted shares issued since initial listing are through this means.

Of all superior voting shares issued since initial listing, an average of 33.72% are issued for the exercise of employee stock options and warrants versus only 11.85% of restricted shares. Since the most senior officers of a company generally receive the largest number of employee stock options and these officers are often controlling shareholders of dual class firms, it is not surprising that superior voting shares are most frequently issued for employee stock options and warrants. Similarly, 7.19% of superior voting shares versus 3.09% of restricted shares issued since initial listing are issued to employees at a discount. Another major reason why superior shares are issued is for takeover share

exchange offers. Of superior voting shares issued since initial listing, an average of 21.09% are for this purpose. This suggests that many target company shareholders seek a share in the control of the acquiring firm.

### *5.3. Cases of shareholder disagreements and their resolutions*

While the finance literature has focused on concerns related to the initial issuance of dual class shares, there are potential subsequent corporate governance problems. These problems relate to the divergent interests of outside and controlling shareholders. Zingales (1994) cites evidence from Italy that illustrates the importance of the legal system in preventing exploitation of restricted shareholders. He argues that the absence of legal protection for restricted shareholders in Italy accounts for the large price premium of superior voting shares in that country.<sup>5</sup> Thus, a discussion of cases showing how courts resolve disputes between shareholders is critical to understanding the long-term impact of dual class capitalization. Table 8 outlines 12 cases that illustrate the conflicts that can arise between controlling and restricted shareholders.

First, there is concern about the size of the premium sometimes paid for superior voting shares held by controlling shareholders upon either takeover or reclassification from dual to single class shares. In the 1987 takeover of Traders Group, the price per voting share was nearly five times that for non-voting shares. Other cases of different treatment were Tele Capitale in 1979 and Laidlaw Corporation in 1997.

Second, the coattail provisions do not always result in equal treatment between controlling and outside shareholders. As noted earlier, targeted block purchases of voting shares at a premium under 15% to their open market price are consistent with the exempt offer provision and do not trigger a follow-up offer. As shown by the case of Laidlaw in 1988, if there is no follow-up offer to all voting shareholders, the coattail is typically not triggered despite the change in control. Thus, both outside voting and non-voting shareholders are excluded from any takeover premium.

In addition to these exempt offers, there were several cases in which a change in control was effected but the coattail technically was not triggered. These cases include Canadian Tire in 1987, DMR Group in 1995, Schneider in 1997 and WIC in 1998. In the watershed case of Canadian Tire in 1987, the bidder made an offer to increase its ownership from 17% to 66% of the votes. It offered to buy 49% of the voting shares, and the controlling family agreed to tender its

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<sup>5</sup> Michaely and Murgia (1995) document how in Italy the effective tax rate on dividends from superior voting shares is lower than on dividends from restricted shares for most taxpayers. Thus, the premium on superior voting shares may more likely be a reflection of their higher after-tax cash flows.

voting shares, at a price of \$160.24 versus a previous open market price of \$41.50. The coattail provision was not triggered as it required that at least 50% of the voting shares be tendered and taken up. The courts halted the transaction on the grounds it was contrary to the public interest. However, the case raised concerns about dual class firms, and institutions such as Fairvest Securities started to actively lobby against the dual class structure. For example, in 1998, Fairvest Securities successfully lobbied institutional investors to vote against a proposal of Noranda to adopt dual class capitalization. In addition, as shown in Smith and Amoako-Adu (1995), the premium at which superior voting shares traded increased following the Canadian Tire case. As noted earlier, this finding is consistent with the decreased likelihood of a firm going public with dual class equity after 1987.

Another concern raised in the cases of Steinberg, Schneider Corporation and WIC is that the controlling family may sign a lock-up agreement to sell its voting stake to a particular friendly bidder thereby pre-empting competing bidders. On the other hand, Table 8 also describes the cases of Slater Industries and Dylex in which special circumstances allowed holders of restricted stock to successfully eliminate the dual class structure despite objections by controlling shareholders.

Despite the evidence of conflict between the two classes of stock in dual class firms, in the large majority of cases, the two classes of shareholders have been equally treated. Of the 90 complete takeovers of dual class firms (that resulted in the firm being delisted) only 5 involved a differential takeover bid. Of the 56 reclassifications into a single class, only seven involved a higher ratio for superior than for restricted shares.<sup>6</sup> It is also interesting to note that of the 12 controversial cases shown in Table 8, 10 involved non-voting shares. Since the proportion of dual class firms with non-voting shares is declining on the TSE, it is expected that cases in which the treatment of the two classes greatly differs will be less frequent.

#### *5.4. Consolidation back into single class equity*

As noted earlier, a significant portion of dual class firms reclassify their shares into one class. Thus, a dual class structure is a temporary takeover defense for many firms. Table 9 illustrates how a variety of factors led firms to eliminate dual class equity based on the 56 cases on the TSE over the period

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<sup>6</sup> In contrast, Megginson (1990) reports that in 37 of 43 takeovers of dual class firms, a higher price was paid for superior voting shares in Britain. Bergström and Rydqvist (1992) find that 40 of 88 takeovers of dual class firms in Sweden paid differential prices. Ang and Megginson (1989) find that in 45 of 49 reclassifications of British dual class firms into single class firms, each superior voting share received more new shares than each restricted share. Thus, the treatment of restricted shares upon takeover and reclassification differs across countries.

Table 8  
Cases of shareholder disagreement involving dual class firms<sup>a</sup>

Year	Firm	Event	Outcome
1979	Tele Capitale	Verendrye Corporation negotiates agreement to acquire voting shares of three controlling shareholders for \$46 per share while offering public shareholders only \$15.50 for non-voting shares	Shareholders complain to provincial securities commission about unequal takeover offer but no action taken to address concerns
1986–1987	Canadian Tire	Canadian Tire Dealers Holding Limited offers to increase its ownership from 17% to 65% of the voting shares of Canadian Tire Corporation at a price of \$160.24, which a week earlier had traded at \$41.50. Coattail provision was not triggered and no offer was made for non-voting shares. However, coattail would have been triggered if 50% of the voting shares had been tendered and taken up	The transaction is blocked by the Ontario Securities Commission (OSC) and the courts on the grounds that the offer is contrary to public interest
1987	Traders Group	Central Capital buys a private holding company which owned 88% of the voting shares of Traders Group for an estimated value of \$322.50 per voting share. Central Capital soon after offers \$67 for all other voting and non-voting shares	Bid for other voting and non-voting shares raised to \$322.50 and \$70, respectively after strong minority voting shareholder resistance. Traders Group had no coattail provision
1988	Laidlaw	Controlling shareholder sells 47.2% block of voting shares at premium just under 15% of open market price of stock to Canadian Pacific. No follow-up offer to other voting shareholders as offer is “exempt” under Section 92(1)(c) of the Ontario Securities Act. A control block purchase is considered exempt where fewer than six sellers are involved and premium paid does not exceed 115% of the average share price calculated over the preceding 20 trading days	As offer not extended to all voting shareholders, coattail is not activated and non-voting shareholders do not receive takeover offer. Outsider dual class shareholders complain but to no avail

1989	Steinberg	Steinberg family signs lock-up agreement to sell 52% voting control block to Soconav. Soconav offers \$75 for all voting shares and \$51 for non-voting shares. Competing bidder, Oxdon, offers \$75 for voting shares and \$53 for non-voting shares but offer conditional on 90% acceptance by both classes of stock. Offer later raised to \$80 and \$60 for voting and non-voting shares, respectively, but offer conditional on Soconav extending time of their offer and not picking up any further shares until new expiry date	Board rejects Oxdon offer. Soconav wins bidding contest. Institutional shareholders criticize size of premium paid for voting shares
1994	Slater Industries	Under investigation by the Ontario Securities Commission for insider trading, controlling shareholder loses right to vote. Chairman of board calls for a vote to reclassify dual class equity into a single class	Board votes in favour of reclassification into a single class
1995	DMR Group	Controlling shareholder sign a lock-up agreement to tender block of multiple voting shares to bidding company, Amdahl, at \$8.25. Amdahl makes an equal follow-up offer to buy all restricted and superior voting shares from other shareholders. A competing bidder offers to buy all shares at \$9 per share	Court rules that competing bid triggered coattail, converting all shares into a single class, thereby diluting control stake of initial bidder. Amdahl raises bid to \$12.50 for all multiple and single vote shares
1995	Dylex	US-based investment firm, River Road, acquires a large number of the non-voting shares of financially distressed Dylex during 1993 and 1994. Dividends were not paid on preferred and common shares during 1993 and 1994. If dividend on non-voting shares is not paid by 31 December 1994, the non-voting shares automatically acquires a vote. River Road buys a class of Dylex preferred stock in order to block payment of dividend by board of directors to the non-voting shares (as dividends would first have to be paid for any outstanding preferred shares)	Non-voting shares converted to voting shares when no dividends paid on non-voting shares for two years. Posluns family loses 50.1% voting control of firm

Table 8 (Continued)

Year	Firm	Event	Outcome
1997	Laidlaw	Company reclassifies voting and non-voting shares into a single class on basis of 1.15 to 1.0 and 1.0 to 1.0 share exchange, respectively	Reclassification criticized as being too generous to voting shareholders
1997	Schneider	Maple Leaf bids \$19 cash for voting and non-voting shares in hostile takeover offer for Schneider. Schneider board rejects Maple Leaf bid and adopts temporary poison pill. Bid raised to \$22 a share which board rejects. Schneider family then sign a lock-up agreement to tender its 75% voting block to Smithfield Foods of the US in a share exchange offer valued at approximately \$25 at the time of the agreement. Maple Leaf raises its bid to \$29 four days later. The Schneider board reserves opinion on Maple Leaf bid but company's financial advisor finds Smithfield's bid "inadequate" at the time of lock-up agreement and Maple Leaf's bid fair	Class action lawsuit filed against Schneider and board by institutional investors who claim oppression and breach of duty to seek value for all shareholders. The action also sought to have Maple Leaf's bid declared exclusionary so a coattail provision would be triggered, thereby diluting the family voting interest to under 20%. Court upheld right of family to sell to Smithfield. Smithfield acquired voting control of firm but did not acquire enough non-voting shares to take company private
1998	Noranda	Proposal is made to shareholders to split equity of Noranda into two classes of shares with each class electing one half of the board of directors independent of subsequent dilution of each class of shares	Proposal withdrawn by company after meeting opposition from institutional investors led by Fairvest Securities Corp., a brokerage firm specializing in corporate governance



1998	WIC (Western International Communication)	Widow of founding family of WIC sells 49.96% of voting shares to Shaw Communications and sufficient shares to minority voting shareholder, Cathton Holdings, to raise its interest to 49.89%. The family's voting shares are sold for \$61 per share while the non-voting shares are sold for \$39 per share. However, WIC's coattail which can only be triggered if a single party acquires over 50% of the voting shares, is not activated. Canwest which owns the largest equity stake of the firm with 35% of the non-voting shares, argues the transaction is designed to circumvent the coattail provision. Canwest offers \$39 a share for all non-voting shares. Soon after, WIC's board of directors adopts a poison pill. Shaw Communications makes a competing offer at \$43.50 per non-voting share but the offer involved a pre-acquisition agreement that specifies a \$30 million breakup fee payable to Shaw and an option to buy WIC's radio stations for \$160 million	Canwest is unsuccessful in its legal challenge to have the coattail triggered and pre-acquisition agreement rescinded. However, Ontario Securities Commission disallows poison pill. Canwest allows its unsuccessful offer to expire
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<sup>a</sup>This table summarizes the cases of shareholder disagreement involving dual class firms listed on the TSE over the period 1979–1998.

Table 9  
Reasons why TSE listed firms consolidated from dual to single class equity<sup>a</sup>

	Reasons for recapitalization into single class	Number of firms
1.	Recapitalization required as part of debt restructuring	9
2.	Facilitate sale of control block	9 <sup>b</sup>
3.	Increase investor appeal prior to seasoned offering	9
4.	Increase institutional investor appeal in absence of seasoned offering	6 <sup>c</sup>
5.	Adopt shareholder rights plan in lieu of dual class structure	4
6.	Scheduled expiry of dual class structure as established by prior shareholder's agreement	4
7.	Facilitate listing of shares on US exchanges	4
8.	Conversion of investment corporation to open end mutual fund or investment trust	3
9.	Restriction on voting rights removed as government divested ownership in firm	2
10.	Other	6
	Total	56

<sup>a</sup>This table summarizes the reasons why shareholders approved recapitalization of dual to single class equity structure. Information was gathered from proxy circulars and newspaper articles.

<sup>b</sup>Of the nine cases, five were sold through private purchase agreements, two were through secondary offering and two through share repurchase.

<sup>c</sup>In four of these cases, largest shareholder still had >30% of votes after recapitalization to single class.

1979–1998. In 9 of the cases, financial distress led to a debt restructuring plan that required elimination of dual class shares. In such cases, control by the largest shareholder is normally lost and there is a need to reduce the leverage of the firm by issuing new equity. To make this equity more attractive to outside investors, a single class structure is established. Similarly, in the nine cases where a controlling shareholder sold a block of shares, reclassification to a single class was used to increase the appeal of the shares to outside investors.

Nine firms in the sample stated that they wished to reclassify their equity into a single class in order to prepare for a seasoned offering. Specifically, it was argued that outside investors, especially institutions, wanted greater liquidity. This is consistent with Kunz and Angel (1999) who document that liquidity of Swiss non-voting shares increased following reclassification of equity into a single class. Another six firms also stated that they wanted to increase institutional investor interest even in the absence of a seasoned offering. Other reasons indicated for reclassification into a single class of equity included adoption of a shareholder rights plan in lieu of the dual class structure, the scheduled expiry of the dual class structure as established by prior shareholder's agreement, and a plan to list on US exchanges where interest in dual class share firms was lower than in Canada.

## **6. Conclusions**

This paper examines the changes in capitalization and control of dual class firms following IPO. It analyses the reasons why firms issue two classes of equity, how the dual class structure affects subsequent equity issues and whether control by the original controlling shareholder is maintained more frequently in dual versus single class share firms. The paper also examines the post-IPO conflicts that arise between controlling and outside shareholders in dual class firms and finally discusses the reasons why firms consolidate their dual class equity back into a single class.

Logit regression results indicate that a firm's choice of dual class structure at the time of IPO is related to the type of controlling shareholder. The controlling shareholders of dual class firms are generally families or individuals, some of whom are pyramiding control through ownership of multiple dual class firms. The results also indicate that controlling owner's previous use of dual class shares tends to positively affect the probability of adopting dual class capitalization. Because of the Canadian Tire controversy in 1987 and the accompanying increase in price premium of superior voting shares, firms were less interested in going public with dual class capitalization after that year. Technology firms are significantly less likely than companies in other sectors to adopt dual capitalization. There is no consistent evidence to indicate that the age and size of a firm are significant determinant factors when deciding to adopt dual class capitalization.

Time series evidence suggests that dual class firms tend to issue considerably more restricted than superior voting shares subsequent to the IPO. For those dual class firms that maintain a dual class structure over 15 years, the percentage of equity needed to have a 50% voting stake in these firms decreases from 25.75% to 11.25%. The two most common reasons for post-IPO issuance of restricted shares are seasoned offerings and conversion of superior voting shares. For post-IPO issuance of superior voting shares, the most common reasons are first, warrants or employee stock options and second, share exchange offer. The latter results suggest that senior management and target firm shareholders value control.

In the 10-years subsequent to IPO, the percentages of dual and single class firms that experience changes in the largest controlling shareholder are not significantly different. Ten years after IPO, only one-third of dual class firms had the same controlling shareholder. This suggests that in most cases, dual class equity is used to prevent hostile takeover as opposed to preventing a sale of control per se.

This paper also documents how in a subset of cases, dual class equity leads to open conflict between different classes of shareholders in the years following IPO. Areas of conflict include disputes over differential prices offered for restricted and superior voting shares upon takeover or reclassification into a

single class. These disputes pit controlling shareholders who hold blocks of superior voting shares against institutional shareholders who tend to hold blocks of restricted shares.

Finally, concurrent with the increased frequency of shareholder disputes there is evidence of a trend away from dual class structure on the TSE. In addition to delisting of dual class firms as a consequence of takeovers and financial distress, 56 firms eliminated their dual class structure through reclassification into a single class. Approximately half of the reclassifications were attributable to three reasons: to meet the terms of a debt restructuring agreement, to facilitate the sale of a control block, and to increase institutional appeal for stock prior to seasoned offering. The high frequency of reclassifications indicates that one of the goals of dual class capitalization is to serve as a temporary rather than a permanent anti-takeover mechanism.

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