

How are publicly-traded corporations controlled?

A brief look at single and dual class share ownership

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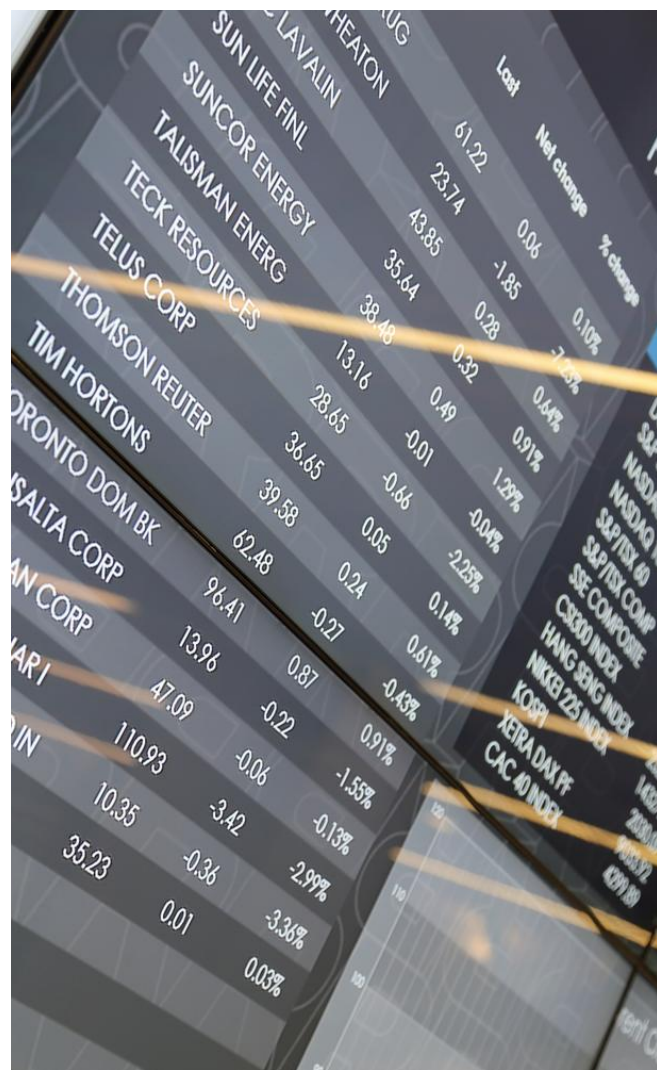
In theory, the control of a publicly-traded corporation can be shared among members of the public. Control is acquired by buying one or more of the corporation's shares—units that represent the monetary value of the buyer's investment—in a public market, such as the Toronto Stock Exchange (TSX). Through the purchase of shares, investors become owners. Owners can be individuals (including the corporation's founders, executives, and board members, or unaffiliated members of the public), or other corporations (such as a pension fund, or the corporation's founding company). Owners have the right to vote on a variety of corporate policies and decisions that control the direction of the corporation. The ownership of a public company can be organized using a single type of share—also called a class—or multiple classes of shares. The use of a single or dual class of shares gives different rights to owners.

Single Class Share Ownership

In Canada, the ownership structures of most publicly-traded corporations are organized through the use of one share class. 87% of corporations listed on the S&P/TSX Composite Index offer a single class of shares, giving equal rights in the control of the company to all investors. Each owner's voting rights are proportional to their investment; for every share owned, a shareholder has the right to cast one vote, when electing board members, appointing auditors, approving by-laws and by-law changes, and more (Government of Canada, 2016).

However, even within a single share class, the ownership of a corporation can be nuanced and may not look the same from one corporation to another. Shareholders may not have the capacity to invest equally into a corporation. One shareholder may own more shares than any other shareholder, and therefore have more voting rights than any other shareholder. For example, TransAlta Renewables' largest investor owns 60.1% of the electricity provider's shares (2021, p. 8). As a result, it has the power to decide the entire board of directors at annual elections.

A corporation with a single share class may also have an agreement with one or more shareholders, granting rights that outsize their share ownership. The partnership forged by the agreement is often beneficial to the corporation's growth. For example, TransAlta Renewables' largest shareholder is also entitled to nominate a majority of directors for election, as long as it maintains 35% share ownership in the company (2021, pp. 8-9). Although the agreement grants voting rights that are disproportionate to the shares owned, it also limits those rights by outlining a minimum ownership requirement. Specific events that terminate the agreement are typically included in its terms, such as the sale of all or a proportion of the shares.



Dual Class Share Ownership

Some corporations have two (or more) classes of shares, in order to give specific shareholders—such as founders or executives—voting control, and ultimately decision-making rights. One class (also referred to as super-voting shares) typically entitles owners to more votes per share than the other class, and may not be available via public markets like the TSX. The other share class either provides the right to one vote per share owned (also referred to as subordinate shares) or no votes (also called non-voting shares). Owners of subordinate or non-voting shares are referred to as minority shareholders, because their voting power represents less than 50% of all votes.

As a result, although all owners can benefit and suffer from the corporation's financial gains and losses, owners of a superior share class bear lower financial risk—because they collectively hold fewer shares as compared to minority shareholders—and greater control over the direction of the corporation through their superior voting rights. For example, owners of media company Corus Entertainment's Class A shares only hold 1.6% of all shares in the corporation, but have 100% of the voting power; owners of Class B shares hold 98.4% of all shares in the corporation, but have 0% of the voting power (2021, p. 10).

The voting control imbalance created within many dual class share structures can be managed through the use of tools that limit their duration, also called sunset clauses. For example, when Canadian retailer Alimentation Couche-Tard's youngest controlling shareholder reaches age 65, all Class B superior voting shares will revert to subordinate or single voting Class A shares; the corporation's sunset clause will be realized in April 2022 (2021, p. 56). Catherine McCall, Executive Director of the

Canadian Coalition for Good Governance, also recommends that subordinate shareholders have the opportunity to vote, every five years, on whether they want dual classes to continue (Hansen, 2021).

Proponents of the use of dual class shares argue that the structure encourages and protects longer term decision-making. According to Professor David Beatty, Director of the David and Sharon Johnston Centre for Corporate Governance Innovation, "executives are usually pressured by investors to make decisions that result in rapid share price growth—[fiscal] quarter by quarter—called short-termism." "Widely held corporations are also predated upon by activists," continues Beatty. "Last year in Canada there were 50 reported activist attacks. Drop your comparator group standing in quarterly earnings per share and you will be attacked. Leaders of dual class companies are insulated from these two terrible pandemics of short-termism and activism—and there is no vaccine—and that means they can focus entirely on the longer term success of their corporation." Financial success has been observed, especially in Canada's family businesses. The National Bank of Canada's NBC Canadian Family Index (38 publicly-traded, controlled companies as of 2020, 24 of which have dual class shares) generated a cumulative total return of 180.9% versus the S&P/TSX Composite's 140.5%, from June 2005 to June 2020 (2020, pp. 19, 30).

Dual class share structures are not common among publicly-traded corporations in Canada. 13% of S&P/TSX Composite Index constituents offer two or more share classes. In addition to Corus Entertainment and Alimentation Couche-Tard, other examples of companies on the Index with dual class shares include Rogers Communications, Shopify, and Canadian Tire.

Discussion

Publicly-traded corporations can be controlled using both single and dual class share structures. Although dual class share structures are usually designed to prioritize the rights of select shareholders, disproportionate control can also exist in single class corporations. Limitations can be set on dual class share structures—such as through the use of sunset clauses—as well as on investor agreements that may be present in both single and dual class corporations.

1. Do minority shareholders bear greater risk in a single or a dual class share structure with disproportionate control? Why?

2. In addition to sunset clauses, what are other ways that minority shareholders can manage the risks of disproportionate control?

3. What, if any, are the benefits in a dual class share structure for minority shareholders?

References

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