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Dual-Class Structures and Classified Boards: Evidence from 2018-2023

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Introduction

Dual-class[1] stock structures and classified boards are perennial issues in corporate governance, drawing sustained attention from both market participants and academics. Commissioner Mark Uyeda of the Securities and Exchange Commission (SEC) recently highlighted these issues as ones with a financial impact on valuations that has "been known for a long time."[2] Among all publicly traded U.S. companies, those with dual-class structures are more likely to have classified boards than companies with single-class structures (50.00% versus 39.82%). Dual-class structures grant outsized voting rights, relative to other classes of stock with equal economic rights, usually to insiders such as founders. The concern for investors, as owners of the corporation, is that these insiders may have incentives that do not align with maximizing long-term shareholder value. For example, a founder at a poorly performing dual-class company may remain CEO due to outsize voting rights when he or she might otherwise be removed by the board of directors.

While shareholders can usually influence corporate behavior by electing board members and casting other important proxy votes, dual-class structures limit, or even eliminate, the ability of public investors to influence corporations in this way. With classified boards, the entire board of directors does not stand for election at the same time. Instead, shareholders may only vote on a subset of the total board each year. This makes boards (and, by extension, management) less accountable to shareholders. It may take more than one year for shareholders to vote out a majority of directors whose actions do not align with shareholders' views.

Proponents of dual-class structures offer several justifications, including allowing a founder to implement his or her vision, protecting the corporation against hedge funds and incentivizing companies to go public. Proponents of classified boards argue that these structures can provide more continuity and stability, as well as protections against hostile takeover attempts.

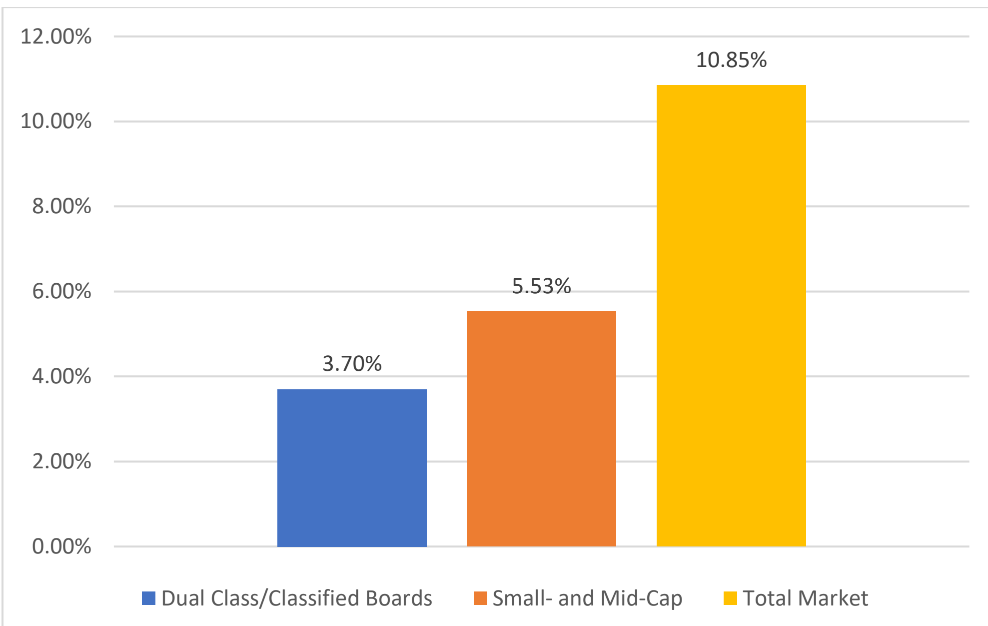
[1] The term *dual-class* is frequently used as short-hand for any structure where there is more than one class of stock with voting rights that are disproportionate to the percentage ownership of the company. For a broader review of dual-class structures, see Lucian Bebcuk and Kobi Kastiel's The Untenable Case for Perpetual Dual-Class Stock, Virginia Law Review, (2017) and CII Summaries of Key Academic Literature on Multi-Class Structures and Firm Value. Uyeda's remarks cite The Life-Cycle of Dual Class Firm Valuation, European Corporate Governance Institute, (June 30, 2022) by Martijn Cremers, Beni Lauterbach, and Anete Pajuste; and Reexamining Staggered Boards and Shareholder Value, Journal of Financial Economics, (Sept. 2017), by Charles Wang and Alma Cohen.
[2] Mark Uyeda, SEC.gov | Remarks at the 2022 Cato Summit on Financial Regulation, (2022).

Recent Research

CII staff analyzed a list of publicly traded U.S. companies with both indefinite dual-class structures and classified boards.[3] Findings are presented separately for companies that have been public for five or more years and for companies that have been public for less than five years.[4]

For companies that have been public for five or more years, annualized returns were significantly lower than broad stock indices. These companies had an average annualized return of 3.70% (median was 5.07%). Figure 1 below shows this annualized return compared to the total return of small- and medium-cap U.S. companies (5.53%) and the U.S. total market (10.85%) for the same time period.[5]

Figure1. U.S. Public Companies with Both Dual-Class Stock (without Sunset Provisions) and Classified Boards. 5-Year Annualized Total Return and Select Indices.



[3] Data source: Diligent Market Intelligence (formerly Insightia) Company Governance Data and Analytics Tool; U.S. companies with "Active Dual Share Class" and "Staggered Board." Companies with time-based sunsets were excluded, based on CII's list of time-based sunsets, (1/24/2023). There may be additional sunset provisions that are not time-based beyond this list (e.g., those based on stock performance or employment of the founder). A company could have a sunset provision for classified boards; however, CII's staff is not aware of any examples.

[4] For determining average and median performance of companies with dual-class structures and classified boards, all companies were equally weighted with dividends reinvested.

[5] Results measured through the total return of the Vanguard Total Stock Market Index Fund ETF for the total U.S. market and the Vanguard Extended Market ETF for small- and mid-cap companies.

Table 1 below identifies the 10 companies from this dataset with the lowest annualized returns over the 5-year period.

Table 1. 10 Lowest Returns, U.S. Public Companies with Both Dual-Class Stock (without Sunset Provisions) and Classified Boards. Public 5 Years or More.

Company	5-Year Annualized Total Return
Informatica	-21.54%
Zuora	-20.17%
Noodles & Company	-20.61%
Phibro Animal Health	-20.14%
Via Renewables	-19.63%
Bandwidth	-19.08%
Hersha Hospitality	-17.64%
RE/MAX Holdings	-17.08%
Designer Brands	-16.69%
The Cato Corporation	-15.80%

Stock prices are the result of a wide variety of factors, not just corporate governance variables, but these companies may warrant additional attention from investors.

Returns were also calculated for companies that went public more recently than five years. These companies had an annualized return of -22.32% since the date they went public. Table 2 lists the companies with the lowest annualized returns for this period, which varies depending on how long the company has been public.

Table 2. 10 Lowest Returns, U.S. Public Companies with Both Dual-Class Stock (without Sunset Provisions) and Classified Boards. Public Less than 5 Years.

Company	Total Annualized Return
WeWork	-90.38%
IronNet	-89.76%
Bird Global	87.91%
Root	-80.75%
Sunlight Financial Holdings	-75.60%
Owlet	-75.41%
TuSimple Holdings	-74.01%
AdTheorent Holding Company	-71.99%
Vimeo	-67.86%
Faraday Future Intelligence Electric	-66.72%

Because these companies have been publicly traded for only a short period of time, it may be too early to draw any long-term conclusions. But they may warrant attention over time.

Conclusion

Dual-class structures and classified boards remain a topic of attention and debate by market participants and academics. Regulators have raised concerns about these corporate governance practices and recent analysis suggests that companies with both had lower total stock returns between 2018 and 2023. Further research could explore the relationship between long-term shareholder value and these governance practices, including the effectiveness of responses such as time-based sunsets.