Do Control Enhancing Mechanisms (CEMs) matter for IPOs

Based on *Why do IPOs choose controversial governance structures and why do investors let them? (2020)*

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Corporate Governance

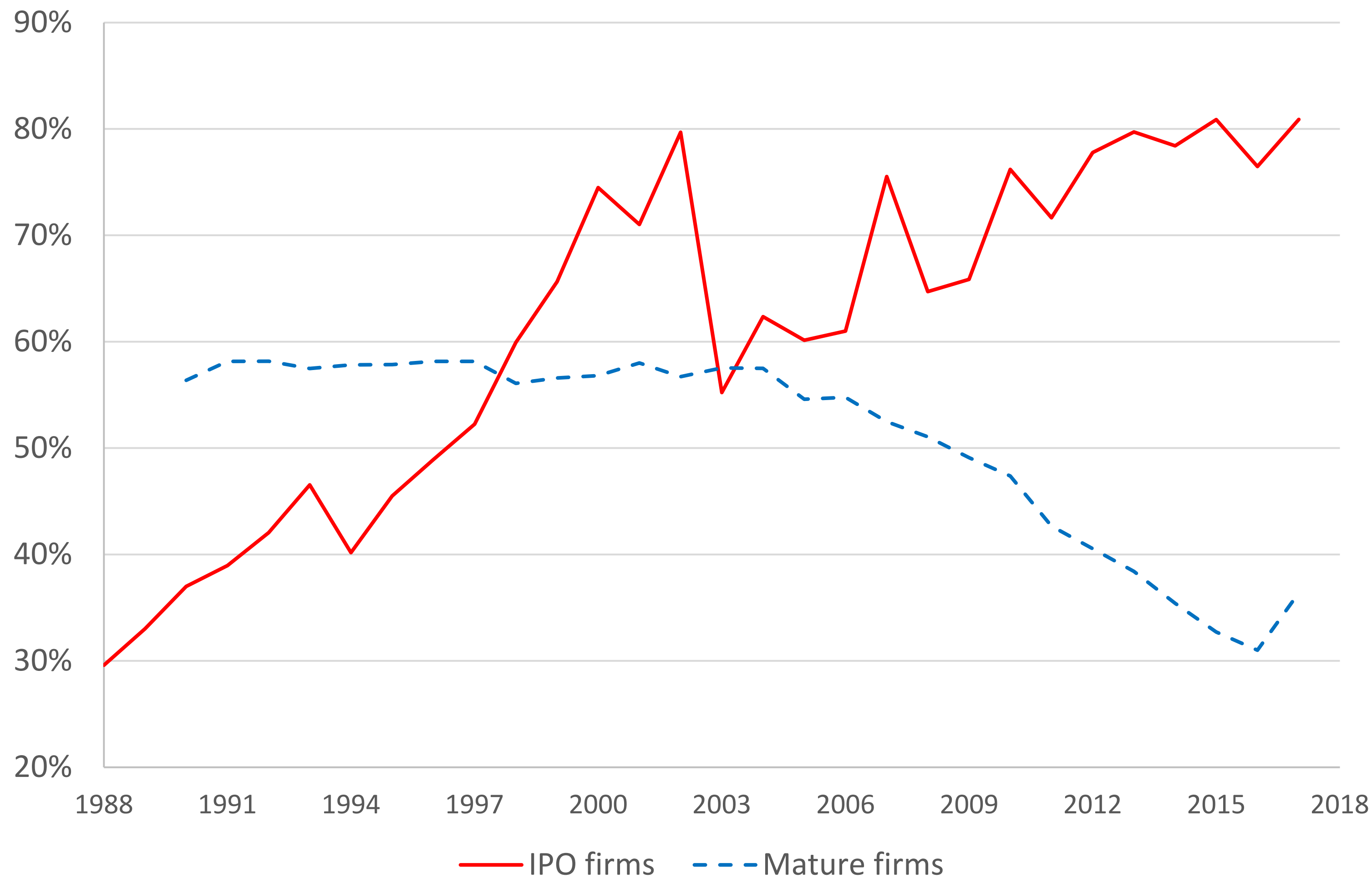
- Balance of power between management and shareholders
  - Better for management to have more control, i.e., have CEMs? "dictatorship"
  - Better for shareholders to have more control? "democracy"

- Objective of this paper:
  - One set of firms becoming more "democracy-like"
  - Another set of firms becoming more "dictatorship-like"

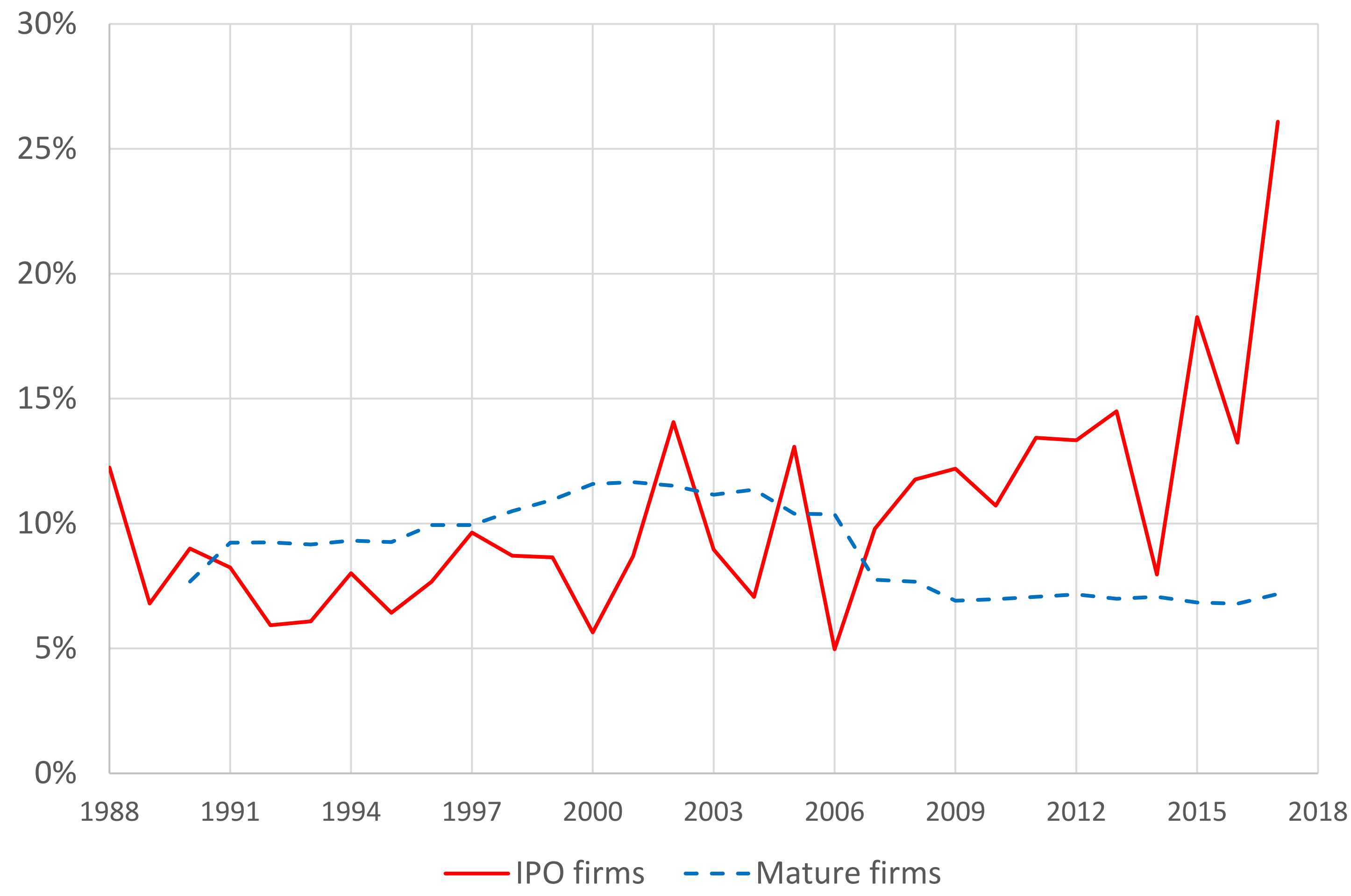
  WHY?

- Focus on
  - Frequency of Classified Boards and Dual Class
  - In newly public firms, compared to mature firms

Percent of firms with classified boards



Percent of firms with dual class



What types of firms are dual class

- Are dual class IPOs predominantly founder firms? Not really
  - 38% of dual class firms are founder firms
  - 62% of dual class firms are NOT founder firms

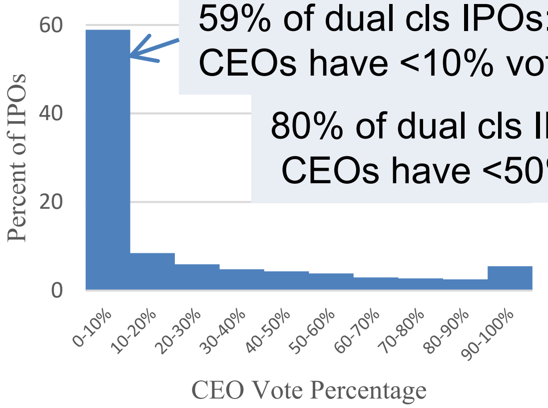
- What other types of firms choose dual class share structures?
  - 17% of dual class firms are equity carve-outs

  - Equity carve-out firms choose dual class for different reasons
    - Within 5 years, they are substantially more likely to
      - Switch to single class
      - Be acquired

- Do insiders control the majority of votes?

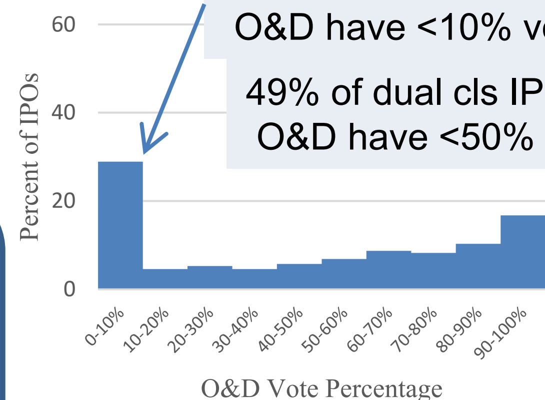
Voting power within Dual class IPOs

All Dual Class IPOs



59% of dual cls IPOs:
CEOs have <10% voting power

80% of dual cls IPOs:
CEOs have <50% voting power

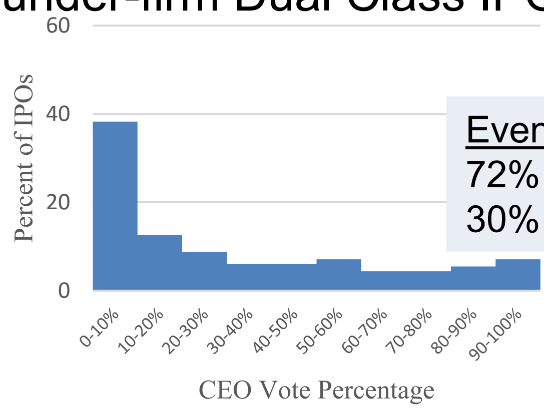


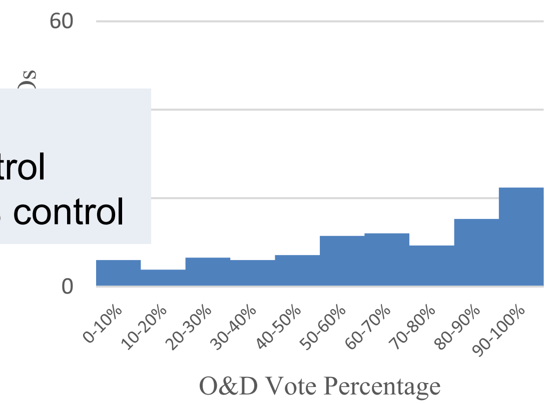
29% of dual cls IPOs:
O&D have <10% voting power

49% of dual cls IPOs:
O&D have <50% voting power

Heterogeneity within Dual: Some less likely to be char'd by Agency than others

Founder-firm Dual Class IPOs





<u>Even among founder IPOs:</u>
72% of cases CEO has <50% control
30% of cases, all O&D have <50% control

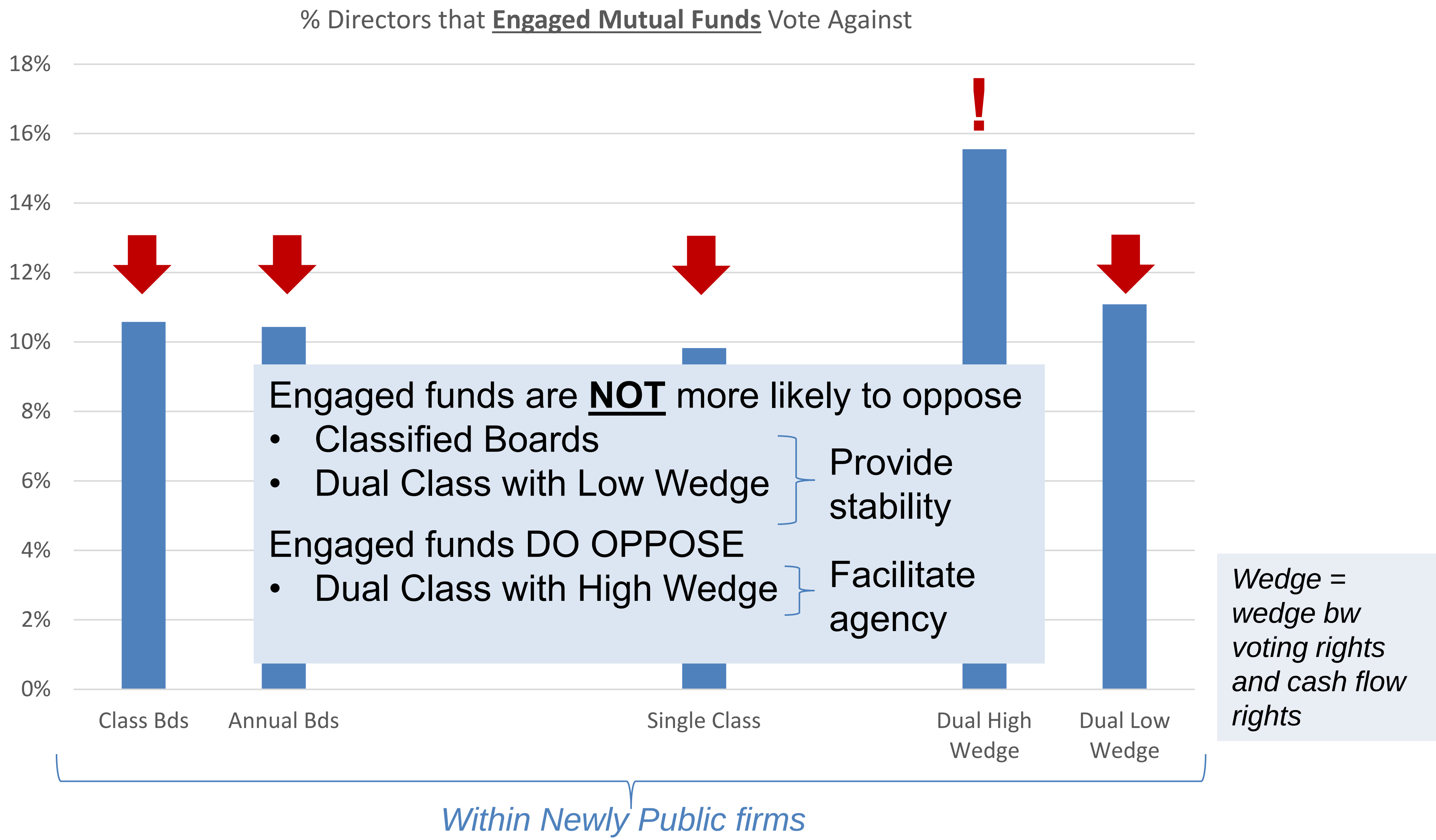
CEMs – Classified Boards and Dual Class: Are they value-destroying?

- One option: Compare post-IPO performance of firms with
  - Classified boards vs Annual Boards, Dual class vs Single class
  - Problem: severe endogeneity
    - NO natural experiment that randomly assigns governance structures
    - NO instrument that is related to gov'ce choices but not performance

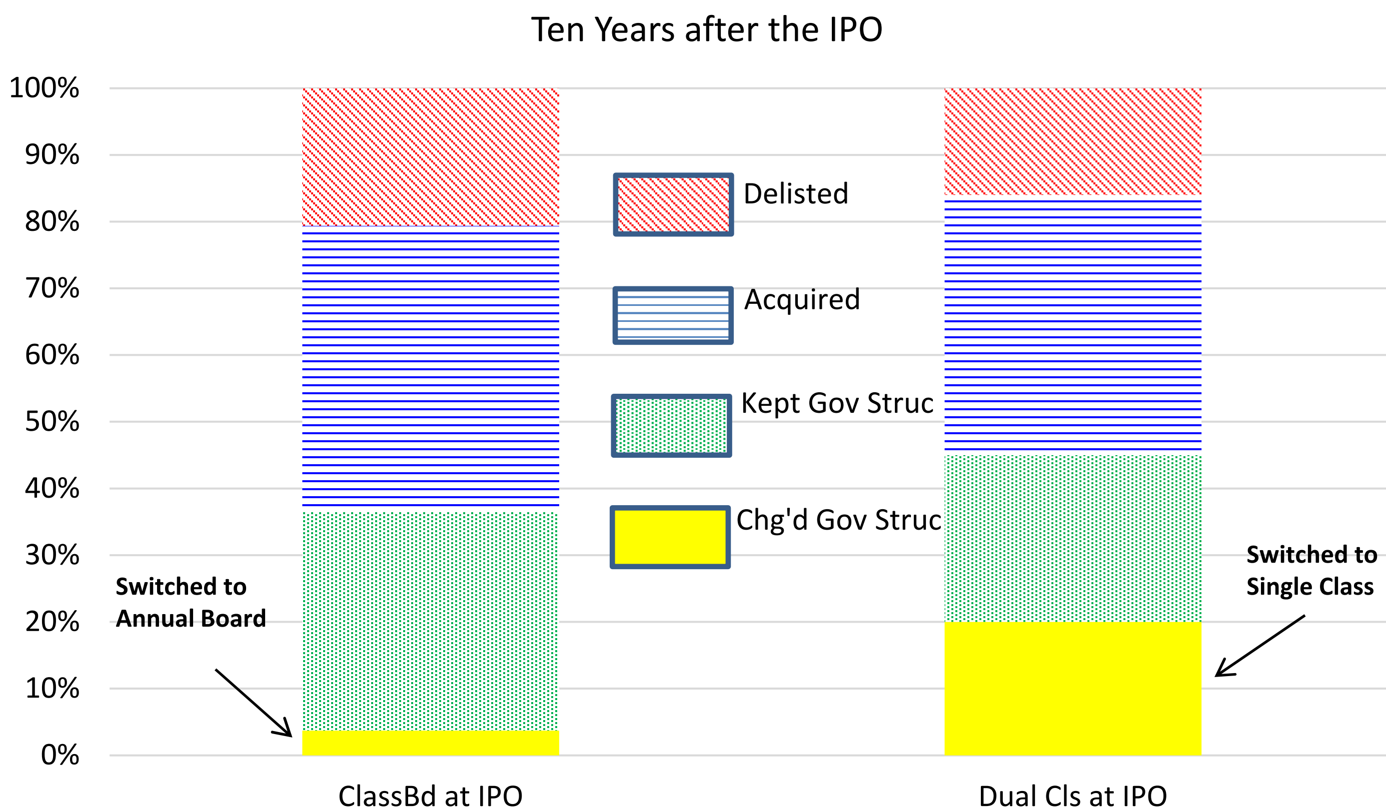
- Alternative option: Compare investors' (dis) satisfaction of firms with
  - Classified boards vs Annual Boards, Dual class vs Single class
  - Shareholders vote annually on governance issues within firms
    - Focus on subset of investors who evaluate issues up for vote on a co.-by-co. basis, 'engaged voters'

Compare votes on dirs. of firms w/
- Class Bds vs Annual Bds
- Dual Class vs Single Class

How do **engaged funds** vote? Field and Lowry (2020)



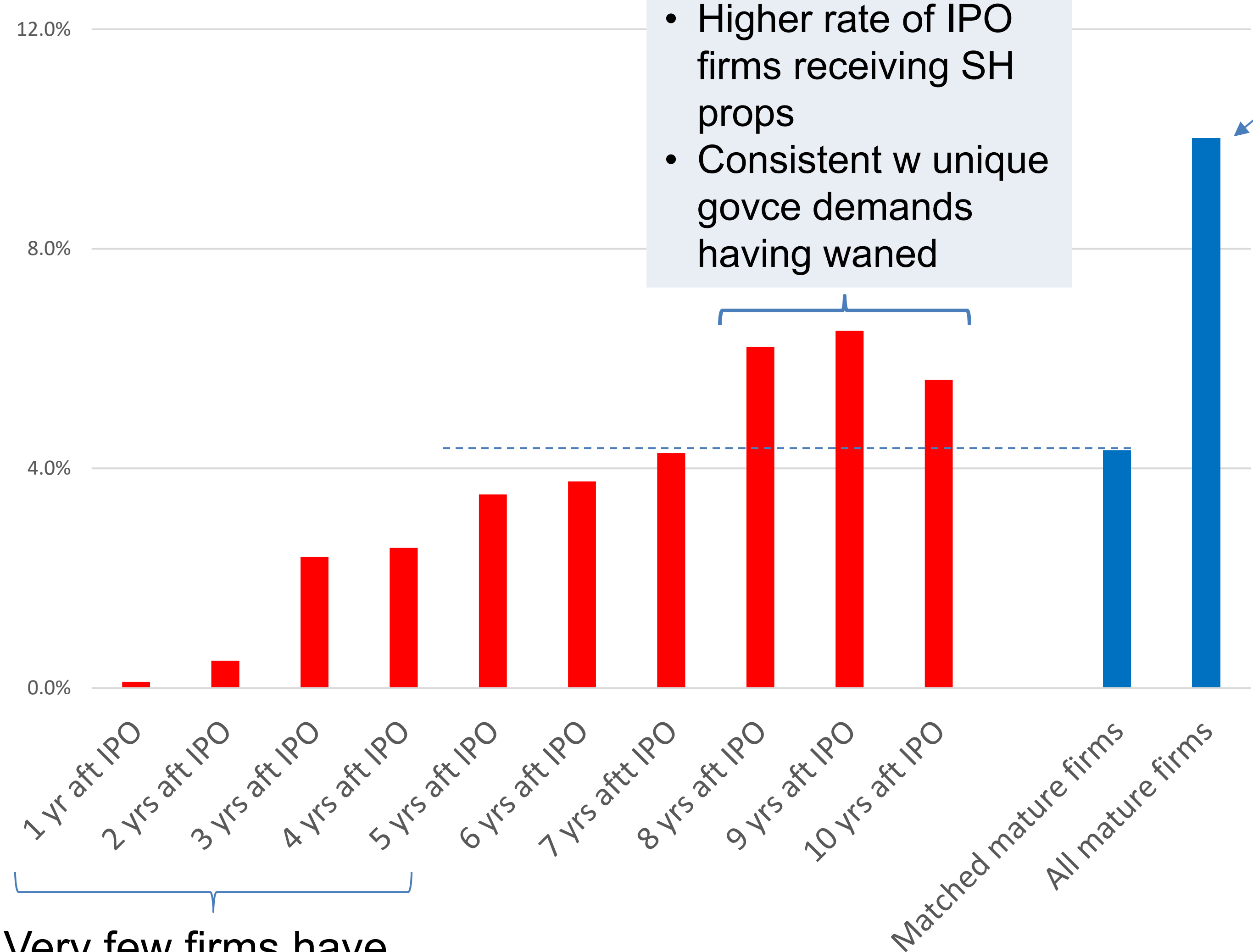
Do firms change from dual class after IPO?



10 years after IPO, these firms are still more likely than other mature firms to have these structures

What makes these structures 'sticky'?

Why don't more firms change structures by yr 10?



- Higher rate of IPO firms receiving SH props
- Consistent w unique govce demands having waned

But rate still much lower than that of all mature firms

This facilitates ability of these (mostly smaller) past IPO firms to maintain inefficient govce structures

Very few firms have SH prop through yr 5

Conclusion

- Dual class structures with high concentration of control
  - Entities with skin in the game oppose
  - Consistent with these structures facilitating agency costs
- Dual class with less concentration of control; Classified Boards
  - Entities with skin in the game do not oppose
  - Consistent with IPO firms choosing these structures bc they provide stability and flexibility to focus on long-term
- These structures are less likely to be optimal as firms mature
  - But these governance structures are sticky