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Dual-class unifications and corporate governance in Brazil

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A B S T R A C T

We investigate dual-class unifications in a period following the successful inception of a premium single-class listing segment. Firms that unified increased their market liquidity. Investment opportunities and shareholder rights convergence drove unification of firms that later joined the new premium list. Financial constraints impelled unification firms that remained in the least demanding list. All unified firms that joined the new list remained there five years later. Half of the others delisted or were in serious financial distress. The motivations for unification may differ according to the ability of firms to improve their corporate governance and transparency later.

1. Introduction

The use of non-voting stock is common in many countries. They enable company financing without dilution of control. Non-voting shares are also a way to offer market liquidity to controlling shareholders who do not need to sell their voting shares at market prices. Maury and Pajuste (2011), Dittmann and Ulbricht (2008), and Amoako-Adu and Smith (2001) see non-voting shares as a natural stage in the growing process of a firm, which may be followed by the public issuance of voting shares, and the eventual unification of the dual-class share structure to abide to the one-share-one-vote principle. Jordan et al. (2014) suggest that dual-class companies boast a larger total dividend payout, that decreases after

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unification, as a potential compensation for outsider shareholder expropriation. Dual-class unifications may dilute control and impose a cost on major shareholders (Bigelli et al., 2011). In contrast, greater voting shares liquidity and market value improve partial or total controlling block sale or equity capitalization conditions and are frequently cited reasons to unify. Maury and Pajuste (2011), for example, assert that market values increase after unifications. Even so, Adams and Ferreira (2008) admit that the empirical literature does not suggest that the one-share-one-vote principle is optimal in every case.

Our main motivation was to investigate if unifications were related to a subsequent migration to a newly created premium listing segment that imposes the one-share-one-vote principle. Brazil offered an interesting opportunity to ascertain if stock unifications are employed as a response to a change in the self-regulatory environment, whose adherence is entirely voluntary, even under somewhat adverse pre-unification ownership conditions, such as very high control concentration (Maury and Pajuste, 2011). The creation of premium lists may offer the opportunity to investigate unifications under two listing requirements under the same jurisdiction. The decision to unify and migrate to a more demanding list that was attracting IPOs and investors may be associated with different pre-existing and ensuing conditions than those of firms that unified but did not migrate. Firms that unify and migrate had to see clear advantages in incurring the costs of doing so.

Our Brazilian sample contrasts with those of previous studies in developed markets. The vast majority of Brazilian listed firms in 2000, the first year of our sample, were dual-class firms, in contrast to a much smaller percentage in the European sample of Maury and Pajuste (2011), for example. Two additional characteristics of our Brazilian sample before unification are that the largest shareholder owned an average of 50% of the voting shares and that the percentage of non-voting shares in the equity capital was very high at 42%, as the law allowed up to two-thirds of the equity capital to be non-voting. It was common for the largest shareholder of the companies in our sample to own a proportion of the non-voting shares larger than their voting shares percentage holding, in contrast, again, with the European sample of Maury and Pajuste (2011). It may be that Brazil represents a more extreme case among the largest emerging markets in what regards some ownership characteristics.

Our main contribution is that the motivations for unification may differ according to the ability of firms to later commit to a broader set of corporate governance and transparency changes. The pre-unification financial situation of a firm conditions its voluntary adherence to more demanding corporate governance and transparency requirements. The listing change decision that may follow unifications seems to be associated with the ensuing company performance as well. Greater convergence of control and cash flow rights of the largest shareholder before unification was significantly associated with the likelihood of unification while the proportion of non-voting shares in the equity capital was not.

This study may be meaningful to other developing nations where usage of non-voting shares is common. Brazil is an important and large developing economy and similar to other emerging economies in the levels of investor protection and transparency. Some emerging markets have or may consider enacting voluntary commitments to more demanding listing segments or requirements while displaying large controlling shareholder stakes. From a policy standpoint, this study may provide clues to some of the potential consequences of such innovations, in particular in what regards the pre-existing conditions that may lead existing dual-class listed firms to meet the one-share-one-vote principle in new institutional settings. Moreover, studies about unifications in emerging markets are scarce, as suggested by our literature search, and we hope that our study helps fill this gap and contribute to future investigations.

We examined 33 stock unifications in Brazil in the 2000–2008 period, which includes the 2005–2007 period when most of them occurred. We initiated our sample in 2000 because this was when the Brazilian stock exchange introduced three new premium listing segments. These new lists demand greater transparency and stricter corporate governance practices from the companies that voluntarily join them. Novo Mercado (NM) is the most demanding of the premium lists and requires that companies have only voting shares in their equity capital, conforming to the one-share-one-vote principle. The introduction of the premium lists was a response of the Brazilian stock exchange to the low IPO activity and increasing trading fragmentation in favor of the US stock exchanges that took place in the late 1990s, when many Brazilian companies issued American Depository Receipts (ADRs) under much more demanding listing requirements.

There were very few initial public offers (IPOs) in Brazil from the mid nineties until 2004 when the first three companies went public to list in NM. The 2005–2007 period saw a surge in the number of IPOs until