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The survival of the U.S. dual class share structure☆

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ABSTRACT

In his groundbreaking work "Uncertainty, Evolution, and Economic Theory," Armen Alchian (1950) suggests that survival is the real test of a firm's success. In this paper, I apply the survival test to the use of dual class share structures in the United States. Beginning with its original implementation by the International Silver Company in 1898 to the prevalence of dual class initial public offerings in 2013, I review the evolution and continued sustainability of the dual class structure in the United States. I contrast the structure with the failed use of tracking stocks and illustrate the structure's continued resilience alongside "competitive" anti-takeover devices such as poison pills, staggered boards, and supermajority voting requirements. Despite the external challenges from legislative bodies, shareholder rights groups, and institutional investors, the dual class structure has survived as an alternative means to raise capital for founders and/or controlling stockholders.

1. Introduction

In "Uncertainty, Evolution, and Economic Theory", Armen Alchian (1950) introduces the biological concept of natural selection to economic analysis. He suggests that in a world of uncertainty "profit maximization is meaningless as a guide to specifiable action" and that "realized positive profits, not maximum profits, are the mark of success and viability." In effect, it is survival of the fittest. "Those who realize positive profits are the survivors; those who suffer losses disappear." Regardless of management's noble intentions, success is measured by survival.

In a typical U.S. public corporation, all shareholders are provided identical voting and cash flow rights. For example, each holder of Microsoft Corporation's stock is allowed one vote for each share she owns. In addition, each shareholder has residual cash flow rights to the firm and can receive dividends. As such, shareholders are separated by the number of shares each owns; however, the proportion of voting and cash flow rights is always proportional to the amount invested in the firm. A shareholder who buys 10,000 shares of Microsoft stock has invested 10 times more capital in the firm than the individual who purchases only 1000 shares. Since each share has identical voting and cash flow rights, the holder of 10,000 shares also has10 times the voting power.

This is not the case in a firm with two classes of stock. In a dual class share firm, the investor who purchases 10,000 shares may have the same voting rights as the holder of only 1000 shares. Voting and cash flow rights can be different based on the class of shares held. For example, Facebook has two classes of stock. Class A shareholders are eligible to vote in all corporate matters; however, they only have one vote per share, whereas class B shareholders have ten votes per share. This allows the holders of class B shares to have

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control of the firm while holding a much smaller cash flow stake. In the case of Facebook, founder Mark Zuckerberg holds 74.3% of class B shares. So although he only owns a 16.6% cash flow stake, his class B holdings give him control of the firm with a 55.2% voting stake.[1]

Because of the dual class structure's separation of economic interests and voting rights, the dual class structure consistently garners criticism. Since the early 1900s, critics have called the structure unethical and inherently anti-shareholder. On the other hand, supporters suggest that the structure allows investors to share in the earnings of companies in which maintaining control is valuable to investors (Alchian and Demsetz, 1972). Despite the debate, shareholders continue to purchase dual class stock as they have for the past one hundred years. In this study, I examine whether the dual class structure passes Alchian's "survival test."

This paper is organized as follows. Section 2 reviews the benefits and disadvantages of the structure. Section 3 reviews the history of the dual class share structure in the United States and points out the evolving nature of the structure. Section 4 discusses the structure's survival amidst the use of alternative anti-takeover mechanisms and contrast the structure with tracking stocks. Section 5 documents the international use of the dual class structure. Section 6 examines the prevalence of the dual class structure through the years and the recent resurgence of the structure in the initial public offering market. Section 7 concludes.

2. Intermediate organizational form

Ever since the original implementation of the dual class structure, the structure has received criticism from both academics and shareholder activist. The critics say it is unethical to stray from a one-share, one-vote structure. While it is true the one-share, one–one vote structure leads to equality among all investors based on their level of holdings, the fact is, organizations are complex. What works best for one firm, is not in the best interest of another. As DeAngelo and DeAngelo (1985) said "dual class firms may be best viewed as an intermediate organizational form which fits somewhere between the polar cases of the dispersed-ownership public corporation and the closely-held firm." Just like some firms choose to remain privately held, while others decide that it is best to go public, some firms decide that it is in their best interests to access the equity markets while retaining control of their corporation through the dual class structure. In their original S-1 filing with the Securities and Exchange Commission, Google stated "As a public company, we believe a dual class voting structure will enable us to retain many of the positive aspects of being private."[2]

By allowing dual class structures, exchanges give both the founders/controlling stockholders and minority stockholders the opportunity to participate in this intermediate organizational form. The dual class structure allows investors the ability to invest in companies which they would not have been able to if the firm had not been able to choose the dual class structure. Take for example, the 2004 IPO of Google. Many investors have made tremendous amounts of money investing in the firm. Should we implicitly assume Google's founders would have taken the company public if they did not have the ability to use a dual class structure? A restriction by the Hong Kong Exchange prevented Alibaba, the largest Chinese e-commerce retailer, from listing and led them to choose the New York Stock Exchange.[3]

The dual class structure allows investors to invest in companies in which they desire the controlling party to remain in power. Alchian and Demsetz (1972) state "in fact, we invest in some ventures in the hope that no other stockholders will be so 'foolish' as to try to toss out the incumbent management. We want him to have the power to stay in office, and for the prospect of sharing in his fortunes we buy nonvoting common stock." Take for example, Ford Motor Company, through their class B shares the Ford family maintains a 40% voting stake in the firm. To some investors and car buyers, it is important for them to know that the Ford family's reputation is at stake. In the case of Google, the company's founders, Sergey Brin and Larry Page, have a certain vision for the company. It is important to investors that Google keeps their long-term focus and is not distracted by short term stock price movements or fear of management takeovers. Google's Larry Page stated in Google's original S-1 "we have a dual-class structure that is biased towards stability and independence and that requires investors to bet on the team, especially Sergey and me." Similar to investors in Google and Facebook, media company investors are willing to buy shares in dual class firms knowing their minority voting stake will not change ownership's goal of editorial independence. In a similar manner, institutions and individual investors routinely invest as limited partners leaving control in the hands of general partners.

In order to fully understand the reasons why the dual class structure continues to be used, an in-depth examination of the benefits and disadvantages of the structure must be made. Controlling stockholders make the decision to use the dual class structure because they believe the benefits outweigh the negatives and investors choose to invest at a certain price when they believe the benefits outweigh the costs. The structure's unique intermediate organizational form leads to benefits and disadvantages from two perspectives: 1) the structure allows the firm to operate as if it were a private firm with diffuse ownership and 2) the structure allows the firm to operate as if it were a diffusely owned firm with a strong takeover defense. The two following subsections outline the potential benefits and disadvantages of the dual class share structure.

2.1. Benefits of the dual class structure

If you compare a dual class firm with an otherwise identical private firm, the dual class firm has three benefits commonly found in diffusely owned firms: 1) the ability to raise external capital, 2) the diversification of unsystematic risk and 3) specialized risk bearing.

1 Facebook, Inc., March 31, 2014 Form DEF 14A, via SEC Edgar.
2 Original S-1 Filing by Google, Inc. dated April 29, 2004.
3 Curran, "Alibaba prompts Hong Kong IPO rethink", Wall Street Journal, January 9, 2014.

The first benefit of using a dual class structure is that it allows the family or controlling stockholder to raise public equity while maintaining control of the firm. During the evolution of a corporation, there comes a point where the owner faces a binding wealth constraint and is not able to fund profitable investments for the firm. The owner must decide whether to seek external equity, dilute his ownership stake, and face increased agency costs or limit the future investment of the firm (Jensen and Meckling, 1976). In the typical single class firm, the owners trade-off their control for the additional equity made available to financing profitable projects. In some firms, however, the value of control is so great, because of the investment in firm specific human capital or asymmetric information, that the family or controlling group is not willing to trade-off control for new equity. For these firms, the dual class structure allows the family or controlling stockholder to remain in control while also raising public equity. Thus, allowing the firm to finance profitable investments (DeAngelo and DeAngelo, 1985; Gilson, 1987).

The second benefit of using a dual class structure is that it allows the controlling stockholder to diversify unsystematic risk and specialized. According to the basics of the capital market equilibrium model, investors can reduce their unsystematic risk by holding a diversified portfolio of assets (Lintner, 1965; Sharpe, 1964). For firms with a sole owner/manager it may be in his best interests to reduce his stake in the firm to achieve risk reduction (Fama and Jensen, 1983b; Fama Michael and Eugene, 1985). For dual class firms, the structure allows insiders to maintain control of the firm while also limiting their unsystematic risk.

The third benefit of using a dual class structure is that it allows for specialized risk bearing across residual claimants Fama and Jensen, (1983b). In a simple proprietorship, the proprietor is able to manage contracts across suppliers and managers with relatively low risk. As the firm grows more complex, the manager's aversion to risk will lead them to increase the costs they charge the company. By bringing in outside investors who have diversified portfolios themselves, the owner can lower the overall cost of risk to the firm (Fama and Jensen, 1983b; Fischel, 1987; Gilson, 1987).

If you compare a dual class firm with an otherwise identical diffusely owned firm, the dual class firm has four benefits provided by its anti-takeover property: 1) increases investment in organization specific human capital, 2) prevents uninformed takeovers, 3) reduces managerial myopia, and 4) potentially increases takeover premiums.

The first benefit associated with the anti-takeover property of the dual class structure is that it potentially increases investment in organization specific human capital. Each firm has its own unique organizational structure, set of investment opportunities, human capital, and methods of doing business. Because of this uniqueness, managers must invest their time and resources in becoming an expert at their specific firm. Once they have acquired this firm specific knowledge, they have more value to their firm than to the general firm. The managers' incentive to acquire this firm specific knowledge is directly related to their expectation that they will be able to remain at the firm. If the firm is acquired and management is changed, the manager will not receive the expected return on their firm specific investment. In firms with a dual class structure, managers are able to maintain control of the firm through superior voting stock. This control provides incentive to managers to invest in firm specific human capital (DeAngelo and DeAngelo, 1985; Fischel, 1987; Klein et al., 1978). Along these lines, Google stated in their original proxy statement "we believe the stability afforded by the dual-class structure will enable us to retain our unique culture and continue to attract and retain talented people who are Google's life blood. Our colleagues will be able to trust that they themselves and their labors of hard work, love and creativity will be well cared for by a company focused on stability and the long-term."[4] In addition, Johnson et al. (2014) show that firms use takeover defenses such as dual class structures at their initial public offering to help bond the firm's commitment to its business partners. By guaranteeing that there will not be a management takeover, the firm strengthens its business relationships and potentially increases firm value.

The second benefit is that it prevents uninformed takeovers. In a world of asymmetric information, the insiders of the firm know more about the firm's investment projects and managerial performance than outsiders. These uninformed outsiders may seek to remove the firm's management group based on their limited knowledge of the firm. The firm's insiders will take steps to send signals to outsiders that managers are making proper decisions for the firm. These signals can be costly to the firm and may include high debt-equity ratios, dividend changes, or share repurchases. In firms with a dual class structure, the manager control of the firm prevents these uninformed takeovers. Therefore it reduces the costs that would be incurred by management to signal outsiders that they are making proper decisions (Alchian and Demsetz, 1972; DeAngelo and DeAngelo, 1985; Fischel, 1987).

The third benefit of using a dual class structure is that it potentially reduces managerial myopia. The market for corporate control monitors the management of firms and acts as a disciplinary force. When a firm's management does not act in the best interest of stockholders, a new management group may step forward and oust the poor performing management team. Because of this constant threat of takeover, a firm's management group may become too concerned with the current stock price or quarterly earnings. This myopic behavior can lead management to shift funds from long-term strategic projects to short-term projects which can be easily identified and valued by outsiders. However, when management uses the dual class structure to shield themselves from takeover, the management group is freed to act in the long-term best interest of the firm (Fischel, 1987; Shleifer and Vishny, 1990; Stein, 1988). In Google's original registration statement, the founders expressed this benefit of the dual class structure in the following quote: "We also believed that searching and organizing all the world's information was an unusually important task that should be carried out by a company that is trustworthy and interested in the public good. We believe that a well functioning society should have abundant, free and unbiased access to high quality information. Google therefore has a responsibility to the world. The dual-class structure helps ensure that this responsibility is met. We believe that fulfilling this responsibility will deliver increased value to our shareholders."[5]

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[4] Original S-1 Filing by Google, Inc. dated April 29, 2004.

[5] Original S-1 Filing by Google, Inc. dated April 29, 2004.

The next benefit of using a dual class structure is that the dual class structure potentially increases takeover premiums. In a firm with dispersed ownership, it is very difficult for shareholders to act as a collective unit. When faced with a tender offer, the inability to act as a collective unit leaves the shareholders with a significant negotiating disadvantage. Even further if the shareholder elected board of directors does not own a significant stake in the firm, they may not act in the best interest of all shareholders. In a firm with a dual class structure and concentrated voting power, superior voting shareholders gain significant bargaining power. With increased negotiating ability, the shareholders are able to affect a higher takeover premium. Thus, the dual class structure may reduce the number of control transactions but increase the price paid (Comment and Schwert, 1995; Fischel, 1987; Smart and Zutter, 2003).

Table 1 summarizes the potential benefits of the dual class structure:

2.2. Disadvantages of the dual class structure

While the concentration of control with the dual class structure may provide benefits to shareholders, the separation of voting and cash flow rights has at least two potential disadvantages. The first disadvantage to the dual class structure is that management can become entrenched under the structure. The firm's stock price is the best measure available to quantify the success of a firm. In turn, the firm's success is directly related to actions by the firm's management. Thus, there exists a positive correlation between a firm's managerial efficiency and their firm's stock price (Manne, 1965). It follows that poor management will lead to a reduction in stock price relative to other firms in the industry. As the stock price falls, outside firms see potential gains from replacing the poor management with a more efficient management team. The further the price falls the more attractive the firm becomes. When the potential gains become large enough, the outside firm will seek to take-over the poorly managed firm. Consequently, the market for corporate control acts as a monitor to management and provides disciplinary action to consistently underperforming firms. With a dual class structure in place, management is able to maintain control through ownership of superior voting shares. This control insulates management from the market for corporate control and allows management to continue making poor decisions without repercussion (Fama and Jensen, 1983a; Gilson, 1987; Jarrell and Poulsen, 1988).

The second disadvantage to the dual class structure is that it increases agency costs. As ownership dispersion increases in the single class firm, a separation in ownership and management occurs (Berle and Means, 1932). This creates an agent–principal relationship between management and shareholders. As the separation grows larger, the agent (management) may not act in the best interest of the principal. This results in agency costs, which Jensen and Meckling, (1976) categorized as monitoring costs, bonding costs, and residual loss (reduction in welfare due to the divergence of opinion between shareholders and management). One method of reducing agency costs is for the firm to have a large controlling shareholder or family which can act as both owner and manager. By acting as both, the family has both the incentive and monitoring power to efficiently operate the firm. In firms with a dual class structure, there is typically a large shareholder or family which has majority control of the firm. However, due to the nature of the dual class structure the family may not hold a majority position in the firm's cash flows (see Google, Ford). Because of their reduced cash flow position, the family will be more willing to use corporate resources for their own personal benefit. This extraction of private benefits of control comes at the expense of minority shareholders (Barclay and Holderness, 1989; Bebchuk et al., 2000; Masulis et al., 2009).

Table 2 summarizes the disadvantages of the dual class structure:

Table 1
Dual class share structure benefits.

Benefit	Intuition
As compared to an otherwise identical private firm:	
Increases the ability to raise public equity	Families and managers face binding personal wealth constraints. The dual class structure is used in firms where control is valuable yet cash-flow ownership is not practical due to the large scale of value increasing projects available to the firm (DeAngelo and DeAngelo, 1985; Gilson, 1987). Without the dual class structure, these firms where control is valuable may remain private.
Increases the ability to diversify unsystematic risk	By maintaining control through a dual class structure, families and controlling stockholders can limit their exposure to unsystematic risk by limiting their investment in the company (Fischel, 1987; Gilson, 1987).
Specialized risk bearing	The dual class structure allows external security holders to diversify their risk across many firms (Fama and Jensen, 1983b). By allowing specialized risk bearing the firm's cost of equity should decrease (Fischel, 1987).
As compared to an otherwise identical diffusely owned firm:	
Increases investment in organization specific human capital	By maintaining voting control through the dual class structure, management is able to more firmly define their property rights to returns on their investment in organization-specific human capital (DeAngelo and DeAngelo, 1985; Klein et al., 1978). Without the ability to maintain voting control, the returns may be appropriated to another management group.
Prevents uninformed takeovers	Management's control on voting rights through the dual class structure prevents uninformed outside stockholders from mistakenly replacing the management team with a less productive group (Alchian and Demsetz, 1972; DeAngelo and DeAngelo, 1985).
Reduces managerial myopia	By maintaining voting control through the dual class structure, managers are able to thwart any takeover attempts. By removing the threat and associated fear of takeovers, managers are able to focus on the long-term objectives of the firm rather than short-term profits (Shleifer and Vishny, 1990; Stein, 1988).
Increases takeover premium	The dual class structure acts as an antitakeover device. The antitakeover property increases the relative bargaining positions of the target and decreases the position of the bidder. Thus, increasing the bidder costs and the gains to the target dual class firm (Comment and Schwert, 1995; Smart and Zutter, 2003).

Table 2
Dual class share structure disadvantages.

Disadvantage	Intuition
Entrenches management	By maintaining voting control through the dual class structure, managers insulate themselves from the market for corporate control. This prevents stockholders from receiving the potential benefits from an acquisition and allows managers to pursue objectives inconsistent with value maximization (Fama and Jensen, 1983a; Gilson, 1987; Jarrell and Poulsen, 1988; Partch, 1987).
Increases agency costs	By creating share classes with disparate voting and cash flow rights, the dual class structure creates a wedge between the control and ownership interests of management. As the wedge grows larger, management is able to exert more control on the firm while at the same time they become more willing to waste corporate resources due to their limited economic interests in the firm (Bebchuk et al., 2000; Jensen and Meckling, 1976; Masulis et al., 2009).

3. History of the U.S. dual class share structure

Using environmental adoption (adaptation) as a guide, Alchian (1950) suggests that firms utilize an "adaptive, imitative, and trial-and-error behavior in the pursuit of positive profits." Similarly, the dual class structure has followed an evolutionary path to success. In this section, I review the history of the dual class structure and conclude with a summary of its evolutionary changes.

3.1. Early history (1898–1926)

The unbundling of cash flow and voting rights dates back to the turn of the twentieth century. Up until then, issues of both common and preferred stock were given full voting rights. It was not until 1898 when the International Silver Company authorized twenty million shares that non-voting stock was first issued. The authorization was for nine million preferred and eleven million non-voting common shares. Later in 1902, the common stock was given the right to vote; however, it was given only one vote for every two shares owned (Stevens, 1926). The non-voting stock issued by the International Silver Company opened the door for firms to begin unbundling cash flow and voting rights between common and preferred stock.

In the 1920s, firms began to issue two classes of common stock giving only one class the right to vote. As an example, in 1925 Dodge Brothers issued 1.5 million shares of class A non-voting stock, while the control of the firm was held by the investment bank of Dillon, Read, and Company who owned 250,001 shares of class B voting stock. The public's purchase of the class A stock, bonds, and preferred stock totalled $130 million while the investment bank's controlling investment was a mere $2.25 million (Seligman, 1986). By the year 1926, at least 183 other firms had issued both class A and class B stock (Dewing, 1953).

Stock issues such as those by Dodge Brothers, Industrial Rayon Corporation, A&W Root Beer, and Fox Theaters led Harvard University Professor William Ripley to speak publicly about "the years of the Split Common Stock and Vanishing Stockholder."[6]. His initial address in October 1925 to the Academy of Political Science in New York City led to articles in the New York Times, Nation, Atlantic Monthly, and to his book, Main Street and Wall Street, published in 1927. Ripley's railings against these "management shares" are summarized in the following quote: "Yet the plan [dual class system] bears every appearance of a bald and outrageous theft of the last title of responsibility for management of the actual owners by those who are setting up these latest financial erections. Isn't it the prettiest case ever known of having a cake and eating it too?" (Ripley, 1927).

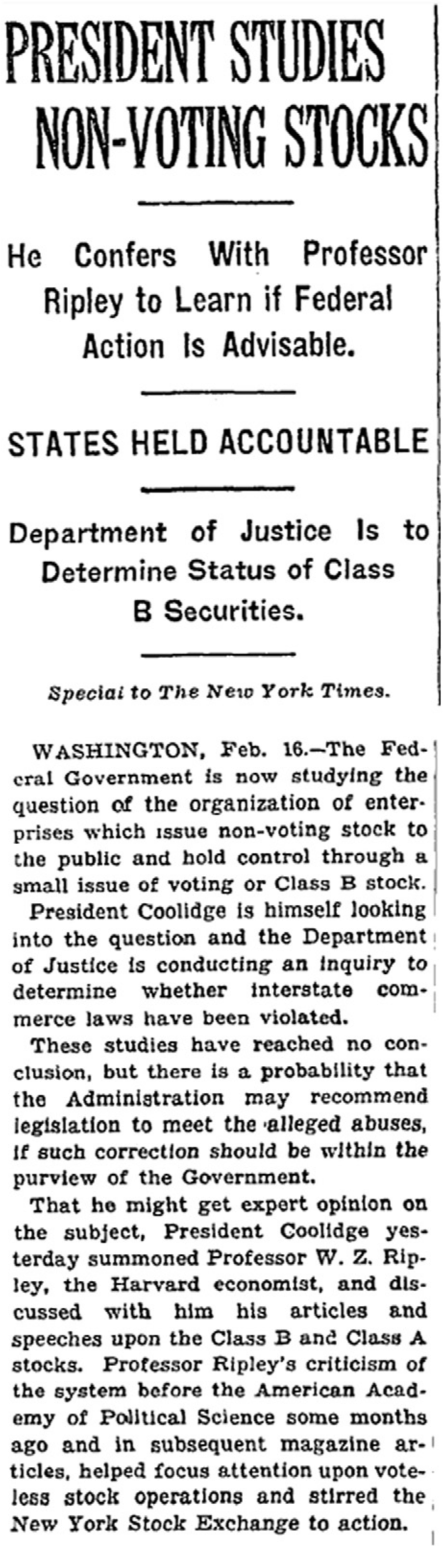
Along with Mr. Ripley's public speaking, scholarly articles were written by Adolf Berle (Berle, 1926) and W.H.S. Stevens (Stevens, 1926) addressing the one-share, one-vote controversy. Mr. Ripley's condemnation of the structure received widespread attention and the public outcry led to the first disapproval by the New York Stock Exchange (NYSE) to an issue of non-voting common stock on January 18, 1926. After the disapproval the NYSE issued the following statement: "Without at this time attempting to formulate a definite policy…the Committee…will give careful thought to the matter of voting control." The outcry also led President Calvin Coolidge to invite Ripley to personally discuss the issue. The February 17, 1926 NewYork Times headline read "President studies non-voting stocks: He confers with Professor Ripley to learn if federal action is advisable" (See Fig. 1).

3.2. NYSE prohibition period (1926–1985)

After their initial disapproval in 1926, the NYSE prohibited the issuance of non-voting securities, although they did not formally announce the prohibition until 1940. Between 1926 and 1985, the NYSE kept its prohibition with a few exceptions like Ford Motor Company. Ford Motor Company was able to get around the prohibition by issuing a class with inferior voting rights rather than no voting rights. The firm's class B stock, which was held by the Ford family kept 40% voting power, while the class A stock was given the remaining 60%. This allowed the family to go public while retaining control with only 5.1% equity. Similar proportional voting structures were used in other firms such as J.M. Smucker and American Family. Due to the strict adherence to their policy, Seligman (1986) found only ten NYSE firms with dual class share structures in 1985.

Other exchanges were not as strict with their voting policies. The American Stock Exchange (AMEX) did not implement a non-voting prohibition until 1972. In 1976, Wang Laboratories was unable to list on the New York Stock Exchange due to its proposed dual class capitalization; however, the American Stock Exchange reviewed the application and allowed the listing. This led to the AMEX issuing a policy statement on dual class issues (disproportionate voting rights). The key points of the statement were: 1) the

[6] Ripley, "From Main Street to Wall Street," 87 Atlantic Monthly 94 (1926).



PRESIDENT STUDIES NON-VOTING STOCKS

He Confers With Professor Ripley to Learn if Federal Action Is Advisable.

STATES HELD ACCOUNTABLE

Department of Justice Is to Determine Status of Class B Securities.

Special to The New York Times.

WASHINGTON, Feb. 16.—The Federal Government is now studying the question of the organization of enterprises which issue non-voting stock to the public and hold control through a small issue of voting or Class B stock.

President Coolidge is himself looking into the question and the Department of Justice is conducting an inquiry to determine whether interstate commerce laws have been violated.

These studies have reached no conclusion, but there is a probability that the Administration may recommend legislation to meet the alleged abuses, if such correction should be within the purview of the Government.

That he might get expert opinion on the subject, President Coolidge yesterday summoned Professor W. Z. Ripley, the Harvard economist, and discussed with him his articles and speeches upon the Class B and Class A stocks. Professor Ripley's criticism of the system before the American Academy of Political Science some months ago and in subsequent magazine articles, helped focus attention upon voteless stock operations and stirred the New York Stock Exchange to action.

Fig. 1. President studies non-voting stocks (article excerpt). New York Times (February 17, 1926).

limited voting class must have the ability to elect at least 25% of the board, 2) the voting ratio should not be greater than 10 to 1 in favor of the superior voting class, 3) no additional stock could be issued which diluted the limited voting shareholder stake, 4) superior voting rights would be lost if the number of shares fell below a certain percentage, and 5) dividend preference was strongly

Table 3
The evolution of the U.S. dual class share structure.

Time period	State of the dual class structure
1898–1926	The dual class structure is generally setup using one voting class and one non-voting class.
1926–1985	Due to non-voting prohibitions, the general dual class structure evolves into both classes having voting privileges. One class has less voting rights than the other class.
1985–1994	With increased pressure from the corporate control market, many firms implement the dual class structure by way of recapitalization. Methods such as the "dividend sweetener" method and the "delisting incentive" method lead to claims of coercion.
1994–present	The implementation of a uniform policy leads to a majority of firms implementing the dual class structure at the initial public offering stage and few using a dual class recapitalization.

recommended for limited voting stock. The policy became known as the "Wang formula." Due to their relaxed policies on the dual class structure, (Seligman (1986) estimated approximately 7% (60 of 785) AMEX firms were dual-class in 1985, up from 37 in 1976.[7]

3.3. Hostile takeovers and SEC rule 19C-4 (1985–1994)

During the 1980s, the dual class structure became an attractive mechanism to prevent hostile takeover bids. Since most firms had only a single class of stock, they implemented the dual class structure through various recapitalization techniques. As an example, General Cinema Corporation performed a dual class recapitalization by offering to exchange each common share for a new class B share with ten votes each. The new class B share was not publicly traded and received lower dividends than the common stock. In addition, the class B shares were convertible to common shares but could only be transferred or sold among family entities. As another condition, the class B shares only received 10 votes each if more than 15% of the company's common stock was held by shareholders working in concert and if anyone other than board members were to nominate directors.[8] While the recapitalization required shareholder approval, the company president's family owned approximately 29% of the common shares and the measure passed.[9] With the structure setup in this manner, the minority shareholders found it in their best interest to remain in the common share so they could receive the higher dividend and maintain liquidity. This allowed the family to use the new capitalization as an effective anti-takeover device. As the number of takeover threats increased, more companies sought to use the structure to thwart takeovers.

In order to remain competitive with the American Stock Exchange (AMEX) and the National Association of Securities Dealers (NASD) (who had no such restriction), an NYSE subcommittee submitted a proposal in January 1985 to relax their voting policies and allow securities with disparate voting rights to be listed as long as they met certain conditions. Under pressure from Congress, all three exchanges then worked on a uniform policy. After these negotiations broke down, the NYSE issued a new standard "requiring a company proposing to recapitalize to obtain approval of the plan by a majority of its publicly held shares, as well as a majority of its independent directors."[10]

With all three exchanges now permitting dual-class structures, the structure's use increased. With the relaxed policies and increased use, a new call came from Congress for the regulation against the implementation of the structures. In a letter to the SEC chairman, Representative John D. Dingell, the chairman of the House Energy and Commerce Committee, stated that the "commission has the authority to mandate a one-share, one-vote rule" and that "it is time to move forward with sound and appropriate safeguards."[11] In his law review article on the dual class structure, Seligman, (1986) states "disproportionate voting stock is the corporate law equivalent to price-fixing" and "the SEC or Congress should proscribe dual class capitalizations for the largest business corporations."

As the discussion moved forward another view emerged. Rather than prohibit dual class structures all together, the focus became dual class recapitalizations where existing shareholders are effectively coerced into giving up their voting rights. In a New York Times article, Steven Greenhouse asks "If management controls 55% percent of the stock and pushes through unequal voting, is that fair to other stockholders?"[12] Following this reasoning, (Gilson, 1987) examines the dual class structure and leveraged buyouts as substitutes and concludes "a resolution-prohibition of dual class transactions but not dual class capital structures-becomes apparent. That resolution would leave intact the benefits of the dual class capital structure, while still preventing any dominant shareholder group from using dual class transactions [recapitalizations] to coerce a firm's public shareholders." This new approach led to the proposal of rule 19C-4 by the SEC.

On July 7, 1988, the Securities and Exchange Commission voted 4 to 1 to implement rule 19C-4.

Under the rule, the SEC prohibited self-regulatory organizations from listing and trading the stocks of any company that issued new shares carrying more than one vote per share, but it allowed companies to issue shares with less than one vote per share and permitted those with unequal voting rights to still be traded. As soon as the new rule was passed, questions were raised as to whether the SEC had the legal authority to enforce such policies on self regulating organizations such as the NYSE and NASD. On June 12, 1990, a three judge panel of the United States Court of Appeals for the District of Columbia Circuit unanimously ruled that the SEC had exceeded its authority.

[7] Seligman (1986) also found 110 of 4101 NASDAQ companies were dual-class in 1985.
[8] "General Cinema board seeks new stock class to discourage suitors", Wall Street Journal, November 14, 1984.
[9] "General Cinema Corp. begins exchange offer for new class B stock", Wall Street Journal, January 2, 1985.
[10] "Big board ends equal vote rule", New York Times, July 4, 1986.
[11] "Unequal stock class opposed", New York Times, May 24, 1988.
[12] "Unequal votings rights in stock", New York Times, March 19, 1985.

Table 4
Dual class frequency across the world
United States data is from Gompers et al. (2010). Canadian data is from Amoako-Adu and Smith (2001). Other data is from Faccio and Lang (2002). Nenova (2003) shows counts of dual class firms across 30 countries; however, frequency is not calculated.

Country	Percentage	Year
United States	6.1%	2002
Canada	10.2%	1998
France	2.6%	1996
UK	23.9%	1996
Norway	13.2%	1998
Austria	23.3%	1999
Ireland	28.1%	1999
Germany	17.6%	1996
Italy	41.4%	1996
Finland	37.6%	1999
Switzerland	51.2%	1999
Sweden	66.1%	1998

Table 5
Initial public offerings (2003–2013)
This table shows the number of initial public offerings by year. Data comes from SDC Platinum. Dual class IPOs are identified by reviewing the firm's Securities and Exchange Commission filings.

Calendar year	Number of IPOs	IPO proceeds (M)	Number of dual class IPOs	Dual class IPO proceeds (M)	% of IPOs that are dual class	% of proceeds that are dual class
2003	63	9078.8	6	1029.3	9.596	11.3%
2004	162	29,382.9	17	8562.2	10.5%	29.1%
2005	152	24,600.6	20	5628.4	13.2%	22.9%
2006	146	24,757.7	8	5387.8	5.5%	21.8%
2007	139	22,670.1	12	3288.0	8.6%	14.5%
2008	19	4537.4	1	55.0	5.3%	1.2%
2009	43	14,057.2	6	4675.4	14.0%	33.3%
2010	90	28,565.4	13	3001.8	14.4%	10.5%
2011	77	22,266.8	13	6952.7	16.9%	31.2%
2012	104	31,809.5	18	20,961.0	17.3%	65.9%
2013	147	35,989.2	26	9716.7	17.7%	27.0%
Totals	1142	247,715.6	140	69,258.3	12.3%	28.0%
2003–2008	681	115,027.5	64	23,950.7	9.4%	20.8%
2009–2013	461	132,688.1	76	45,307.6	16.5%	34.1%

Despite the court's rejection of 19C-4, the NASD proceeded with implementing a 19C-4 type rule allowing firms to introduce inferior voting shares during initial public offerings but barring firms from reducing existing shareholders' voting rights.[13] The NASD joined the NYSE who had already voluntarily issued a policy implementing the 19C-4 rule. In June 1991, the AMEX moved to restrict its policy similar to the 19C-4 rule, with the exception that inferior voting shares could be created if approved by two-thirds of the stockholders and a majority of non-insiders.[14]

3.4. A uniform policy (1994–present)

In December 1993, SEC Chairman Arthur Levitt Jr. suggested that all U.S. markets should implement a uniform policy regarding voting rights.[15] In line with Mr. Levitt's suggestion, the AMEX and NASD shortly thereafter approved a uniform policy which was followed by the NYSE in May of 1994. The voting policy allows companies to list with dual class shares and sets no restrictions on the voting rights of new public stock offerings. However, it bars companies from taking steps to reduce their existing shareholders' voting rights through such actions as "the adoption of time phased voting plans, the adoption of capped voting rights plans, the issuance of super voting stock, or the issuance of stock with voting rights less than the per share voting rights of the existing common stock through an exchange offer."

Despite the exchanges developing a uniform policy and preventing coercion through dual class recapitalizations, the structure still receives criticism. The critics call for a one-share, one vote standard and point to the anti-takeover property of the structure, the risk of entrenchment, and potential expropriation of minority shareholders. They contend that insiders with control will take on bad projects, reject sound takeover offers, or just not run the firm effectively. In 2004 when Google went public with a dual class structure,

[13] "NASD plans a one-share, one-vote rule", Wall Street Journal, June 21, 1990.
[14] "AMEX files plan for holders' votes on classes of stock", Wall Street Journal, June 13, 1991.
[15] "NYSE approves shareholder voting rights policy", Dow Jones News Service, May 5, 1994.

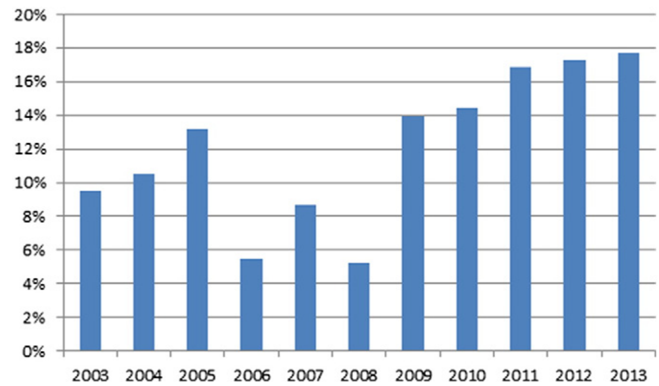


Fig. 2. Percentage of dual class initial public offerings by year (2003–2013). This graph shows the percentage of dual class initial public offerings by year. The initial public offering sample comes from SDC Platinum. Dual class IPOs are identified by reviewing the firm's Securities and Exchange Commission filings.

Bob Monks, shareholder activist, stated "It is stupid to have two classes of stock. I think they have been badly advised."[16] Charles Elson, director of the John L. Weinberg Center for corporate governance at the University of Delaware, added "I think it is a terrible mistake. Any time you separate ownership from control there is trouble down the line."[17]

In recent years, institutions, unions, and blockholders have led shareholder proposals to eliminate the structure and move to one vote per share. For example, in 2007 John Chevedden led a proposal to remove the dual class structure at Ford Motor Company. In the proposal he states "Dual class stock companies like Ford take shareholder money but do not let shareholders have an equal voice in their company's management. Without a voice, shareholders cannot hold management accountable. Shareholders who finance our company should be able to hold our management accountable."[18] The initiative was opposed by the board, yet garnered support from 27% of shareholders.[19] Similar proposals have been rejected at firms such as the New York Times, Google, Emmis, and Sotheby's.

3.5. Evolution of the dual class share structure

Similar to environmental adaptation, the dual class structure has "evolved" in order to successfully remain as an intermediate organizational structure. Table 3 summarizes the evolution of the dual class structure.

4. Survival amidst other anti-takeover mechanisms and tracking stocks

In the process of natural selection, a key component of success/survival is the ability to resist or survive competition. The resurgence of the dual class structure during the hostile takeover period in the 1980s led to an emphasis on the structure's anti-takeover characteristic. While the structure is an effective anti-takeover device, the structure continues to be widely used in the United States after the decline in hostile takeovers and the "just say no" ruling by the Delaware Supreme Court in the case of Paramount Communications Inc. v. Time Inc.[20] In addition the structure continues to be used after the increased usage of other anti-takeover devices such as poison pills and staggered boards in the 1990s. In summary, the structure has survived as a successful organizational form after the decline in hostile takeover and the change in takeover defense tactics in the 1990s (Ryngaert and Scholten, 2010).

Organizational forms exist as long as they are useful. If an organizational form outlives its usefulness it will fade away. Take for example, tracking stocks. Tracking stocks are a type of common stock that tracks the financial performance of a business unit or operating division of a company. They typically have limited or no voting rights and their dividends are based on the performance of the specific unit tracked. Many firms issued them during the internet craze to take advantage of the excitement for dot com stocks. However, now that the internet craze has subsided tracking stocks have all but faded away. As of 2013, tracking stocks are only used by Liberty Interactive Corporation. On the other hand, the dual class structure has remained a viable organizational form after the demise of the hostile takeover market in the 1980s because it has benefits beyond its anti-takeover property. DeAngelo and DeAngelo (1985) state it like this "if dual class structures are inefficient organizational forms, one would expect their importance to decline over time as their deficiencies become more apparent." Over two decades later, the structure continues to be a widely used organizational form.

[16] Foremski, London, and Waters, "Google and the establishment set to clash", Financial Times, May 1, 2004.
[17] Ibid.
[18] Ford Motor Company, April 5, 2007 Form DEF 14A, via Edgar.
[19] Stoll, "Ford shareholders take swipe at family voting power", Dow Jones Newswires, May 10, 2007.
[20] See Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140-1155 (Del. 1990).

Table 6
Survival of the U.S. dual class share structure.

Time frame	Prevalence	Source
1979–1987	129 dual class recapitalizations	Dimitrov and Jain (2006)
1985	2.8% of listed firms (180 firms)	Seligman (1986)
1988–1992	5.4% of IPOs	Field and Karpoff (2002)
1988–1998	49 dual class recapitalizations	Dimitrov and Jain (2006)
1/1990–5/1994	7.0% of IPOs and 9.5% of IPO proceeds	Smart and Zutter (2003)
6/1994–9/1998	11.9% of IPOs and 24.9% of IPO proceeds	Smart and Zutter (2003)
1995–2002	6% of listed firms and 8% of market capitalization	Gompers et al. (2010)
2003–2008	9.4% of IPOs and 20.8% of IPO proceeds	SDC Platinum and Securities and Exchange Commission Documents
2009–2013	16.5% of IPOs and 34.1% of IPO proceeds	SDC Platinum and Securities and Exchange Commission Documents

5. International use of the dual class share structure

While this paper focuses on the survival of the dual class structure in the United States, the structure is also used in many countries under various institutional settings. Because of the trade-offs involved with the dual class structure and regulation, the frequency of its use varies across the globe based on a country's family ownership concentration, market for corporate control, and legal protection for minority shareholders. As an example, in France only 2.6% of firms chose the dual class structure in 1996, whereas, 66.1% of Swedish firms used the structure in 1998 (Faccio and Lang, 2002). Table 4 outlines the structure's frequency of use in countries around the world.

6. Survival of the dual class structure

The second section of Alchian's seminal work “Uncertainty, Evolution, and Economic Theory,” Alchian (1950) is titled “Success is based on results, not motivation.” As has been shown, there are various motivations for firms to use the dual class structure; however, the real test of success for the structure is its continued survival.

In 1985, Seligman, (1986) identified approximately 2.8% of listed firms as dual class. From 1995 to 2002, Gompers et al. (2010) find that 6.0% of listed firms used the dual class structure and they made up 8% of total market capitalization. Since the Gompers et al. (2010) dataset is the most recent comprehensive dataset publicly available, I examine the prevalence of the dual class share structure in initial public offerings since 2003. Table 5 outlines the results. The sample of initial public offerings comes from SDC Platinum. A total of 1142 initial public offerings were identified during the period 2003 to 2013. For each public offering the Securities and Exchange Commission filings were examined to determine if the firm went public with a dual class share structure. Of the 1142 IPOs, 140 firms (12.3%) went public with the dual class structure. In addition, these 140 IPOs make up 28.0% of the IPO proceeds.

Table 5 shows an increase in the dual class structure's use after the 2008 financial crisis. Prior to the crisis, 9.3% of IPOs were dual class. After the crisis, the percentage of dual class IPOs almost doubles to 16.5% and the percentage of proceeds increases to over one third (34.1%). Fig. 2 graphically illustrates the increase in the IPO use of the structure from 2003 to 2013.

From these results it is clear that U.S. companies are frequently raising capital using the dual class structure. Table 6 summarizes the survival of the U.S. dual class share structure since 1979:

7. Conclusion

In 1950, Armen Alchian introduced the biological concept of natural selection to the field of economics. In an uncertain world, a profit maximizing objective does not necessarily lead to success. Success is measured by the survival of the firm. In this paper, I apply the “survival test” concept to the dual class share structure in the United States. The structure's history from a non-voting/voting structure to an IPO instituted superior/restricted voting structure illustrates the adaptive process required for survival. Despite market forces and external pressures, the dual class structure successfully survives as an intermediate organizational form.

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