Dual-class firms have higher market valuations near time of IPO that drop over next six years, study

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Martijn Cremers. Credit: University of Notre Dame

Facebook, Google, Comcast and Berkshire Hathaway are among a number of large companies that have dual-class stock structures, providing controlling shareholders with majority voting power despite owning a minority of total equity.

For these dual-class firms, market valuations are higher early in their life cycles, while the valuation premium tends to disappear about six years after their IPOs, according to new research from the University of Notre Dame.

"The Life Cycle of Dual-Class Firms," released this month by the European Corporate Governance Institute, was co-authored by Martijn Cremers, Bernard J. Hank Professor of Finance in Notre Dame's Mendoza College of Business, along with Beni Lauterbach from Bar-Ilan University and Anete Pajuste from the Stockholm School of Economics in Latvia.

The team examined an extensive matched sample of U.S. dual- and single-class firms in 1980 to 2015 from the time of their IPO. The study found that at around the time of the IPO, dual-class firms tend to have higher valuations than otherwise-similar single-class firms. However, their valuation premium dissipates over time and becomes insignificant about six years after the IPO. On the one hand, dual-class firms that start with a valuation premium when they are young tend not to have any valuation discount when they are mature. On the other hand, for dual-class firms with a valuation discount at the time of their IPO, this valuation discount tends to remain fairly similar over time, on average.

"Our evidence may have some regulatory implications, and can inform the debate regarding dual-class stock financing," Cremers says. "For policymakers, our finding that many dual-class firms have a valuation premium over single-class firms during the first few years after the IPO should provide some legitimacy to dual-class financing. This initial valuation premium suggests that dual-class stocks should not indiscriminately be excluded from stock exchanges or financial indices.

"On the other hand, we also provide evidence that for dual-class firms with an initial valuation discount, this discount seems to persist in the long term, suggesting their public shareholders and the firm itself may benefit from some form of a sunset clause of dual-class structures."

Provided by University of Notre Dame

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