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BOLETIM DE CONJUNTURA

BOCA

Ano V | Volume 14 | Nº 42 | Boa Vista | 2023

http://www.ioles.com.br/boca

ISSN: 2675-1488

https://doi.org/10.5281/zenodo.8076452

BOLETIM DE CONJUNTURA

www.ioles.com.br/boca

IS THE DUAL-CLASS UNIFICATION A GOOD CORPORATE GOVERNANCE PRACTICE? EVIDENCE FROM BRAZILIAN COMPANIES

Pâmela Amado Tristão[1]

Igor Bernardi Sonza[2]

Abstract

The study aims to analyze the influence of dual-class unification in the corporate governance practices adopted by Brazilian companies listed in Novo Mercado (NM). The study sought to understand if the adherence to NM and, consequently, the adoption of one-share-one-vote principle, impacts the Corporate Governance Index calculated with a Factor Analysis with the explicit executive benefits by the estimation of a Diff-in-Difff model, comparing treatment (companies listed in NM) and control companies (Traditional group) over the period 2009- 2016. Our main result shows that companies that joined NM between 2001-2013 did not have better corporate governance practices if compared to companies not listed in special B3 segments. This finding contradicts partially the theoretical evidence and puts in doubt the efficiency of being listed in different segments of B3. A possible explanation lies in the fact that, despite having all the requirements to adhere to differentiated segments of corporate governance, some companies do not do so, generating little difference in terms of governance for both groups.

Keywords: B3 Special Segments; Corporate Governance; Dual-class Unification.

Resumo

O estudo tem como objetivo analisar a influência da unificação das classes de ações nas práticas de governança corporativa adotadas pelas empresas brasileiras listadas no Novo Mercado (NM). O estudo buscou entender se a adesão ao NM e, consequentemente, a adoção do princípio de uma ação-um-voto, impacta o Índice de Governança Corporativa calculado por meio de uma Análise Fatorial com os benefícios explícitos dos executivos pela estimativa do modelo Diff-in-Difff, comparando o grupo de tratamento (empresas listadas em NM) e o de controle (Tradicional) no período de 2009-2016. Nosso principal resultado evidencia que as empresas que ingressaram na NM entre 2001-2013 não apresentaram melhores práticas de governança corporativa se comparadas às empresas não listadas em segmentos especiais da B3. Essa constatação contraria parcialmente as evidências teóricas e coloca em dúvida a eficiência de ser listada em diferentes segmentos da B3. Uma possível explicação está no fato de que, apesar de possuírem todos os requisitos para aderir a segmentos diferenciados de governança corporativa, algumas empresas não o fazem, gerando pouca diferença em termos de governança para ambos os grupos.

Palavras-chave: Governança Corporativa; Segmentos Especiais da B3; Unificação das Classes de Ações.

INTRODUCTION

Brazilian economy has altered over the last thirty years by changes in economic environment, attracting foreign investors' interest to allocate capital in the domestic market share. Consequently, corporate governance mechanisms to reduce the high probability of expropriation of shareholders' rights emerged from the necessity to align the interests between investors and managers to assure the suppliers of finance the return in their investments (SHLEIFER; VISHNY, 1997). Their adoption is justified by the fact that, in low legal protection countries, like Brazil, investors have more difficulty to obtain their

[1] Professor at the Federal University of Rio Grande (FURG). Doctorate in Business Administration. E-mail: pamelamado@hotmail.com

[2] Professor at the Federal University of Santa Maria (UFSM). Doctorate in Business Administration. E-mail: igorsonza@gmail.com

earning mostly due to the possibility of managers and major shareholders getting private benefits (LA PORTA *et al*., 2000).

For Black *et al.* (2014), Brazilian market underwent an important change in the early 2000s by the creation of ascending levels of corporate governance, namely, *level 1*, *level 2* and Novo Mercado (NM- New Market), focusing on companies that, by the voluntary membership, want to offer high standards of disclousure, transparency and better corporate governance practices. Companies that adhere to NM, considered the most demanding one, follow some instructions such us issuing only voting shares conforming the one-share-one-vote principle.

In a typical public company, shareholders elect the board, appoint auditors and approve fundamental changes, participating in the governance of the firm (ANNAND, 2018). Companies with dual-class shares, otherwise, preserve the control while allowing the firm to gain access to capital in public equity markets (LAUTERBACH; PAJUSTE, 2015) as their structure are affected by the divergence of voting and cash flow rights, which suggests that control shareholders get away the wealth consequences of their decisions while enjoying the benefits associated with their decision rights (LI; ZAIATS; 2017), creating a gap between voting rights and cash flow rights (PALAS; SOLOMON, 2022).

Specifically, Common (ON) or Preferred (PN) shares differ by the rights given to investors: votes or dividend preference payment, respectively. By issuing different classes of shares, the separation between ownership (PN and ON holders) and control (only ON holders) can affect the company's performance, which consequences are likely to exacerbate the excess control rights stemming dual share classes (CIESLAK; HAMBERG; VURAL, 2021). In this sense, the use of non-voting stock is common as they allow financing without dilution of control, being considered a way to offer market liquidity to control shareholders who do not need to sell their voting shares at market prices (BORTOLON; LEAL, 2014).

The solution to this problem is the dual-class unification, as all company shares are transformed into one-share-one-vote, which not only eliminate the wedge between vote and ownership, but also dilute de voting power of controlling shareholder (LAUTERBACH; PAJUSTE, 2015). Specially in Brazil, the unification can be considered a good practice of corporate governance, as majority shareholders have more difficulty to expropriate minority shareholders' right, due to the existence of ownership and control structures. In this context, this paper aims to analyze the influence of dual-class unification in the corporate governance practices adopted by Brazilian companies listed in Novo Mercado.

Our main result shows that companies that joined NM between 2001-2013 did not have better corporate governance practices if compared to companies not listed in special B3 segments. This finding contradicts partially the theoretical evidence and puts in doubt the efficiency of being listed in different segments of B3. A possible explanation lies in the fact that, despite having all the requirements to adhere to differentiated segments of corporate governance, some companies do not do so (SELLA; BORTOLON, 2022), generating littledifference in terms of governance for both groups.

The literature shows that more regulated countries, with strong legal protection for minority investors and with low benefits of control companies could go public with dual-class shares, but they should be prohibited or have more restrictions in non-sophisticated markets with high private benefits of control with weak legal protection for minority investor (MARTINEZ, 2021). Baran, Forst and Via (2023) found a positive association between disproportionate insider control and patent output, quality and development efficiency, as well as executive officer innovative risk taking by is adoption.

Emerging countries where reforms of corporate law are designed to protect invetors from facing political opposition may also consider the listing segments a way to increase the shareholders1 protection (MANOEL; MORAES; PUNDRICH, 2022). In this sense, Brazil represents a more extreme case among the largest emerging markets in what regards some ownership characteristics by its extensive use of non- voting shares, like other emerging economies in levels of investor protection and transparency, being considered an interesting case due to the creation of B3 new segments and Novo Mercado'rules (ANDRADE *et al*., 2017).

Although the research of dual-class share is abundant in developed countries (BURKART; LEE, 2008; BENNEDSEN; NIELSEN, 2010; JORDAN *et al*., 2016), whose findings do not provide clear guidance for not developed markets, studies related to unification in emerging countries are scarce (BORTOLON; LEAL, 2014), justifying this study. Furthermore, the growing popularity of dual-class firms draws attention to costs and benefits of unification arrangements in both the academic literature and popular press (BELADI *et al*., 2022; MEIROWITZ; PI, 2022). In this sense, our study contributes to the empirical discussion on the subject, as well as includes a methodological approach not used in previous studies by the estimation of aDifference-in-Difference (DIF) model, which allows the comparison in the ex ante and ex postperiod by creating a corporate governance index.

CORPORATE GOVERNANCE AND DUAL-CLASS UNIFICATION BY THE ADHERENCE OF NM

The corporate governance has as its main discussion the agency problem. According to Jensen and Mecking (1976) it is characterized by a conflict of interests between the agent (managers) and the principal (shareholders) at the time of a negotiation, in which managers focus on their own interests, like private benefits, rather than shareholders rights.

In business corporation's theory, owners of a company's equity are its stakeholders (ARTIDSKIS *et al.*, 2022). In this scenario, one of the main obstacles to develop corporate governance is the separation between ownership and control of large corporations (BERLE; MEANS, 1932). Although high concentrated ownership reduces agency conflicts between managers and shareholders (SELLA; BORTOLON, 2022) in sophisticated and developed markets, the approach accepted for emerging economies, is that major concentrated ownership emphasizes private benefits and expropriation of minority rights (FIELD; LOWRY, 2022).

Based on Brazilian market characteristics of high concentration of shares owned by a few shareholders, better corporate governance practices are used to mitigate the agency conflict between shareholders with incentives to extract private benefits when their proportion of control rights (voting shares) is greater than their cash flow rights (total shares) (BORTOLON; LEAL, 2014). The expropriation of minor shareholder rights in this scenario is encouraged by the issuance of different classes of shares, which have become one of the most controversial issues in today's capital markets and corporate governance debate around the world (MARTINEZ, 2021).

Although the dual-class shares can be considered a way to achieve control in the company with less investment, as investors have the possibility to hold most of the shares withright to vote and a few or non-voting shares, there is a historical debate on whether disproportional voting rights enhance, harm or destroys the shareholder's value (ABDULLAH, 2017; DIMITROV; JAIN, 2006), they violate the one-share-one vote principle, creating the potential agency problem (DOCHERTY; EASTON; PINDER, 2021) The divergence between voting and cash flow rights exacerbates agency conflicts by increasing the entrenchment effect (BELADI *et al.*, 2022), as dual-class shares create opportunities for controlling insiders to entrenchthemselves at the expense of the inferior class shareholders (LOBAVA *et al.*, 2020). Furthermore, insiders' disproportional control rights arising from dual-class shares ca either benefit or harm shareholders who old inferior class of shares (GAO; JIANG; JIN, 2023).

Although studies lead to different approaches and results, taking into consideration Brazilian capital market characteristics of concentrated ownership, the presence of agency problems between major and minor shareholders, the consequences of dual-class issuance and its relation to corporate governance practices is exposed by Abdullah (2017), for them insiders of dual-class firms tend to retain control, which turn their intension doubtful. By this reason, they argue that investor may evaluate the level of corporate governance before investment in dual-class due to the voting rights' inequality, which leads to agency conflicts between controllers and minor investors.

Grossman and Hart (1988) and Gompers, Ishii and Metrick (2010) associate dual-classfirms with entrench management to extract private benefits and expropriate minor shareholders value. For HETTLER *et al*. (2021) they are consistent with self-interest behavior of entrenched insiders who are interested in activities to maintain resources available for their personal benefit. Results obtained by Tian (2013) and Suman (2006) relate dual-class issuance with investment in long-term value by the acceptance of costly projects. For Yeh and Woidtke (2005), disproportional voting rights leads to poor performance and low firm's value.Olhers research argue that companies with numerous classes of shares have better market andoperating performance.

To avoid the expropriation of shareholders rights, some mechanisms are being adopting, which include: (i) the disclousure and transparency of companies, discouraging the manipulation by control groups; and, (ii) converging for one-share-one-vote principle, where the shareholders votes became proportional to the share held, aligning voting and cash flow rights (SELLA; BERTOLON, 2022), reducing the agency problem and eliminating the wedge between vote and ownership, but also dilute the voting power of controlling shareholders (LAUTERBACH; PAJUSTE, 2016).

The high contingent literature discusses possible reasons for unification of dual-class internationally, such as: (i) greater benefits for general shareholders in detriment of the benefitsof control group (GROSSMAN; HART, 1988); (ii) more efficient management (BUKART; LEE, 2008); reduction of the difficulty of mature dual class firms in raising additional capital (MAURY; PAJUSTE, 2011); (iii) the alleviating external equity financing obstacles and, (iv) increasing in the negative media and public opinion that dual class shares increased the cost of issuance (LAUTERBACH; PAJUSTE, 2014).

In emerged countries, like Brazil, the emphasis of this mechanism can be associated with the reduction of control and, consequently, the minority shareholder expropriation and less asymmetrical information. The establishment of B3 new segments (level1, level 2 and NM) in the early 2000s is considered one of the most relevant changes to encourage companies to adopt adequate corporate governance practices as companies must voluntarily join one of the listing segments by complying a set of rules of permanence.

Specifically, the adherence to NM, the segment with the most severe rules, represent an opportunity to signal commitment to better corporate governance practices and access facilitated financing. The exclusion of dual class shares in NM was considered one of the most important mechanisms, taking into considerationemerging market characteristics.

The motivation for unification of Brazilian traded companies differ according to the ability of firms to improve their corporate governance and transparency. Bortolon and Leal (2014) found that unified companies face some advantages like increasing in market liquidity, attract investment opportunities and shareholders rights convergence. Otherwise, is negatively associated to the payment of dividends and positively related to the divergence of rights of the largest shareholder. Matos (2017) found that companies increase market to book ratio value, particularly when a controlling shareholder is present. Due to these issues, the following hypothesis is formulated: *H1: The unification of the dual class shares led to improvements in corporate governance.*

METHODOLOGY

The sample consists of Brazilian listed companies traded on B3 and covers an analysis from 2009 to 2016, the choice for the period of analysis owes to the fact that, despite the were created in 2000, NM companies' adherence was expressive from 2009 and 2013. Our final samples consist of 79 companies. The data was collected by Economatica from companies' balance sheet, income statement, and other financial reports and by CVM site from governance variables. Financial and insurance firms were excluded. The values were adjusted for inflation using the General Price Index – Internal Availability (IGP-DI) and performed by using Stata SE software.

To identify the influence of unification in the corporate governance practices by the model estimation, the first step consists of estimating a corporate governance index by a Factor Analysis, which identifies common dimensions of variability in a set of phenomena trying to describe a set of variables by creating a smaller number of dimensions (BEZERRA, 2009). This analysis focus on the problem of how to analyze the interrelationships' structure (covariates) between a large number of variables with common underlying dimensions definition (factors).

The principal component analysis was used as a method to extract the factors and, as a criterion of rotation, the standardized Varimax rotation.

The corporate governance index was configured based on explicit benefits for the executives: total value of payment (VTR), fixed salary (SaFx), fixed participation (PartFx), fixed benefits (BenFx), other fixed payment (OFxPay), variable bonuses (BVar), participation in results (PartRe) and benefits in option (OpBe). Other variables related to the structure of the board were used: number of members (QMemb), number of paid members (QRMemb), participation in shareholders' meetings (PartMeet), participation in councils (partCo) and PostJob Comission (PJobCo).

Based on the index obtained by the estimation of the factor analysis and to investigate the influence of dual class shares unification in the corporate governance practices adopted by NM companies, we used the KPSM (Kernel Propensity Score Match) Difference in Difference (DID) model. This methodology consists of identifying a specific intervention or treatment (BERTRAND; DUFLO;

MULLAINATHAN, 2003) by comparing the effect of an event on groups affected by unaffected ones (VIG, 2013). Abadie *et al*. (2015) state that the difference in average pre-treatment outcomes between treated and control units is subtracted from the difference in average post-treatment outcomes between treated and control units.

Based in the impact, the time considered, from 2009 to 2016, information from 2009- 2011 was considered the “pre-unification” period in which the value “0” is assigned and from 2014-2016 the “after-unification” period, being “1” assigned, constituting the variable “Unification”. The other variables, “NM joining” refers to the two groups our sample was divided into: treatment companies (that adhered to NM between 2011 and 2013 and, consequently, adopted the one-share-one-vote principle) assigning value “1” and “0” for control

companies (listed in Traditional Group with dual class shares). Companies must have information for, at least, two years before and after the unification. The variables’ interaction generates the DID variable, shown by equation (1).

$$Y_{it} = \delta_0 + \delta_1 . Unification_t + \delta_2 . NM\ joining_i + \delta_3 (Unification_t\ xNM\ joining_i) + \delta_n covariates + \ \varepsilon_{it} \quad (1)$$

Where *i* represents the firms, *t* the time; Y_{igt} is the outcome of interest (the corporate governance index estimated); δ_1 is the estimate of aggregate factors which lead to changes in Y even in the absence of the intervention; δ_2 is the estimate of the differences between the treatment and control groups prior to the intervention; the coefficient δ_3 was calculated by the difference between the treatment group “NM joining” before and after the “Unification” minus the difference between the control group before and after the Unification, as shown in equation (2); δ_1 are the estimates from the covariates and ε_{it} is the error term.

$$\delta_3 = (\hat{y}\text{treatment}\ NM\ joining, Unification{=}1 - \hat{y}\text{treatment}\ NM\ joining, Unificationn{=}0\ - (\hat{y}control\ NM\ joining, Unification{=}0\ - \hat{y}controlNM\ joining, Unification{=}0) \quad (2)$$

Due to different cutoffs on the treatment group (companies had unified dual shares between 2011 and 2013), the estimation of the DID model has been carried out by the Double Difference Matching (DDM), originated by the combination of the Pareto Propensity (PSM) and Differences in Differences model. This estimation defines conditional results for the vector of x covariates and uses non-parametric methods to construct the differences. According to Paredes (2016), this method attenuates considerably the biases due to the unobserved characteristics. We used as covariates of the model: size (total assets);

Leverage (ratio of long/short term debt and equity); Market-to-Book (ratio of market value and book value) and sector.

ANALYSIS OF RESULTS

Initially, to verify the factor analysis adequacy, it was necessary to verify a) the KMO, which verifies if the correlation between each pair of variables can be explained by the other variables included in the model, which must be higher than 0.5 to be considered satisfied. For the variables analyzed in this study, the KMO presented a good coefficient of 0.51; and b) The Barlett test, applied to verify the adequacy of factor analysis for the obtained data that aims to examine the hypothesis that variables are not correlated in the population. To be considered suitable, the significance level in Barlett test might be low, as the level of significance a value equal to zero, it indicates the data's factorability.

After checking the adequacy of the factorial analysis, the second step consists of the identification of the commonalities presented for each of the arranged variables. Finally, for the determination of the number of factors, the analysis of the total explained variance, which mustreach at least 60% of the accumulated variance and eigenvalues greater than 1, was observed (MALHOTRA, 2006), as shown in Table 1. The analysis of the variance percentage showed that the instrument comprises one factor, which explain 80% of the accumulated variance, all with eigenvalues greater than 1. This factor is formed by total value of payment (VTR), fixedsalary (SaFx).

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Table 1 - Eigenvalue

Factor	Eigenvalue	Factor	Eigenvaule
Factor 1	1.67	Factor 7	0.91
Factor 2	1.34	Factor 8	0.88
Factor 3	1.22	Factor 9	0.75
Factor 4	1.09	Factor 10	0.66
Factor 5	1.03	Factor 11	0.42
Factor 6	0.98		

Source: Authors' own elaboration.

After the description of factors, to analyze the model consistency level, the constructs' reliability measured by the Cronbach Alpha has been estimated. Higher its value, better internalconsistency (which varies from 0 to 1). This procedure presented acceptable results, that is, greater than 0.6, indicating internal consistency of the factors (MALHOTRA, 2006). For the "Total remuneration/Fixed salary" factor, the alpha value resulted in 0.68.

The following step consists of estimating the DID model from the dependent variable Corporate Governance Index, which presupposes the existence of a cutoff, the adherence to NM and the adoption of one-vote-one-share, specifically. The results show that the cutoff analyzed, has shown positive coefficient of 0.18 and statistical significance at 10% confidence level, this result indicates difference in terms of the corporate governance practices adopted by companies that adhered to one-share-one-vote principle by the adherence of NM. The difference between treatment and control group has presented statistical significance at 10% confidence level and negative coefficient of 0.10, as shown in Table 2.

Table 2 - Difference in Difference Model

	Coefficient	Std. Error	*t*
Cutoff	0.180*	0.104	1.74
Treatment/Control	-0.109*	0.622	-1.75
DID	-0.065	0.116	-0.57
Constant	-0.062	0.481	-1.29

Source: Authors' own elaboration.

The Difference in Difference (DID) coefficient considers both groups, treatment and control before and after the unification of dual class shares. Apart from its importance, it has not shown statistically significance, showing that, although the difference in the cutoff and the treatment/control have shown statistically significance, these differences together are not. In sum, they show that, companies that unified dual classes shares by the adherence to NM between 2011 and 2013 do not differ in terms of corporate governance if compared tocompanies listed in Traditional group.

This result rejects the hypothesis 1 and contradicts partially the empirical evidence, whose literature shows that companies listed in al B3 Special Segments show better corporate governance (SILVA, 2004; BLACK; CARVALHO; SAMPAIO, 2014). These results are in line with Ferreira (2012) and Macedo and Corrar (2012), who did not identify significant results for companies that joined B3's differentiated corporate governance segments, raising doubts about whether joining them generates governance benefits for companies.

Corroborating with this result and seeking to verify the relevance and evolution of corporate governance as a mechanism that pursue equity among investors, especially in its sense of mitigating the expropriation of minority investors, Silva (2022) did not find statistical significance in Braziliancyclical and non-cyclical consumption companies.

Also, there is the possibility that companies, despite having all the requirements to adhere to differentiated segments of corporate governance, such as the Novo Mercado, do not do so, generating little difference in terms of governance for both groups (traditional and Novo Mercado). Sella and Bortolon (2022) identified that, despite having advantages, other rules maybe be related to the decision not to migrate from companies in the traditional segment, including the requirement to offer 100% tag along on shares and a minimum of free float. Also, the authorsidentified a possible resistance of the controlling shareholders to waive part of its control, sincethe concentration variables of property are also related to the listing in the upper segment. Thisbehavior is also reinforced when they observe that, in the traditional segment, more companiesused pyramidal structures to leverage control in companies.

In this context, Matos (2017) suggests thar the one-share-one-vote adopted by NM companies influences the reduction of potential conflicts between major versus minor shareholders, nevertheless, these companies still have control shareholders, especially family firms. In this scenario, the optimal regulatory model to deal with share unification depends on a variety of local factors, including regulators and policymaker (MARTINEZ, 2021). Similarly, Cevik (2022) argues that only few companies apply dual-class share structure, and its impact on separation of control, as well as clash flow right, is limited, contradicting (CHENG; MPUNDU; WAN, 2020) results', whose findings show that dual-class firms have higher future accounting profitability and less volatile future returns.

Also, Martinez (2021) explains that adherence of one-share-one-volte principle can be explained by three primary factors: entrenchment and agency problems, fairness, and equal treatment of shareholders and, the influence of certain lobbies. Based on this, our results can also be discussed from the factors that motivate companies to join NM perspective, which is not only based on minor shareholders protection, but also related to transparency and reduction of asymmetric information by issuing reports in international standard, monitoring and split over (MATOS, 2017). Furthermore, to join special segments, especially NM, which despite only requiring the issuance of voting shares, does not impose restrictions on indirect ownership structure. Andrade *et al*. (2017) found the presence of indirect structures in 78.8% of companiesin their samples, higher tandhan in the presence of two class of shares (69.5%); confirming that the deviation of rights can be achieved in this way (SELLA; BOTOLON, 2022).

CONCLUSION REMARKS

This study aims to analyze the influence of dual-class unification in the corporategovernance practices adopted by Brazilian companies listed in Novo Mercado by a quantitativeanalysis through the estimation of a corporate governance index with variables related to explicit benefits of the executives and the estimation of DID methodology. Our sample iscomposed by 79 companies in NM and Traditional segment (treatment and control group, respectively) by using PSM to find comparable companies in Traditional group. We conducted the analysis of two periods 2009-2011 (before joining NM) and 2014-2016 (after joining NM).

By rejecting hypothesis 1, our results contradict partially the empirical evidence that listing in special segments, especially NM, leads to improvements in corporate governance, shedding light on the discussion that, being Brazil an emerging market, benefits on the listing are related to better disclousure, high standard reports, minor investor protection, and access to capital. Ferreira (2012), Macedo and Corrar (2012) and Silva (2022) are in line with this result, raising doubts about whether joining to the special segments of governance generates benefits for companies. Our findings led to the understanding that, similar to Bortolon and Leal (2014), the motivations to unify shares seem to differ according to the ability of firms to commit to better corporate governance and transparency practices, which is indicated by their decision tojoin NM.

This study extends the knowledge regarding company behavior by discussing the importance of the regulatory aspect to improve the local market, where changes in legislation are difficult to be implemented and self-regulation incentives can be seen as tools to improve firms' performance. Moreover, it contributes to investor and shareholders to understand companies and their decision to adhere different segments.

Our limitations refer to low number of observations in the sample, which could be expanded given the relevance of special segments and their popularity nowadays. Being the one-share-one-vote principle quite recent in emerging countries, empirical studies related to the theme are still scarce when analyzing Brazilian environment. Future studies should further explore the research regarding the corporate governance by add other variables to the model,

which are not only related to executive compensation, but also related to the market expectation. Furthermore, studies to compare possible evidence on one-share-one-vote in other segments, not only in NM (as all companies traded on B3 can adhere to it) can fill the gap related to shareunification in Brazil, as well as extending the analysis period to regard companies that joined NM after the early 2010s.

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