

Dual class shares — the good, the bad, and the ugly

Mary Leung
Head, Advocacy, Asia Pacific
April 2019



TABLE OF CONTENTS

- 01 Regional developments
- 02 It worked in the US, didn't it?
- 03 Investors, unite!
- 04 Case studies

APPENDIX

- A CFA Institute APAC survey on dual class shares safeguards

01 Regional developments

What is right and wrong with dual class shares?

“ *The advantage of a dual class share structure is that it protects entrepreneurial management from the demands of shareholders.*

The disadvantage of a dual class share structure is that it protects entrepreneurial management from the demands of shareholders. ”

- Andrew Hill, Associate Editor, Financial Times

Stock exchanges in the region

Exchange	Market cap in USD billions	No. of listed companies	Self-listed
Australian Securities Exchange	1,442	2,151	Yes
BSE India Limited	2,298	5,439	No
Bursa Malaysia	470	905	Yes
Hong Kong Stock Exchange	4,443	2,186	Yes
Japan Exchange Group	6,288	3,618	Yes
Korea Exchange	1,841	2,145	No
National Stock Exchange India	2,351	1,897	No
Shanghai Stock Exchange	5,002	1,421	No
Shenzhen Stock Exchange	3,547	2,110	No
Singapore Exchange	795	744	Yes
Taiwan Stock Exchange	1,077	932	No
Stock Exchange of Thailand	576	691	No

Source: World Federation of Exchanges, websites of stock exchanges, OECD, CFA Institute

DCS rules: Hong Kong and Singapore

	HKEX (Effective 30/04/2018)	SGX (Effective 26/06/2018)
Enhanced CG measures	Yes	Yes
Restriction on share transfers	Yes	Yes ¹
Restriction to new issuers	Yes	Yes
Minimum market capitalization	HK\$10bn (US\$1.3bn)	S\$300m (US\$214.3m)
Maximum voting differentials	Yes; 10-to-1	Yes; 10-to-1
Automatic conversion on retirement / incapacity / death of founder	Yes	No ¹
Time-based sunset provisions	No	No
Unique stock code	Yes	Yes
Restriction to particular industries	Yes	No

Note: (1) Conversion to ordinary shares may be averted if voted through by unaffiliated shareholders

Source: HKEX, SGX

Notable DCS IPOs in 2018

Month	Issuer	Country of origin	Listing venue	Market cap (US\$bn)	IPO funds raised (US\$bn)	Current Share price	Price Change %
March	Bilibili	PRC	Nasdaq	4.4	0.4	17.80	54.8%
March	iQiyi	PRC	Nasdaq	12.8	2.2	26.38	46.6%
July	Xiaomi	PRC	HKEX	30.5	4.7	11.74	-30.9%
July	Pinduoduo	PRC	Nasdaq	20.1	1.6	29.09	53.1%
September	Meituan Dianping	PRC	HKEX	30.9	4.2	56.85	-15.1%
December	Tencent Music	PRC	NYSE	21.3	1.1	18.10	39.2%

Source: NYSE, Nasdaq, HKEX, Reuters

02 It worked in the US, didn't it?

Key differences between US and Asia

	US	Hong Kong
Class action	✓	✗
Derivative action	✓	Limited in practice
Financing of legal action	✓	✗
Retail participation on the stock market	Through funds, brokers and advisors	Significant direct, retail involvement
Duty of directors	Fiduciary duty owed to shareholders	Fiduciary duty owed to the company

Case study: Facebook

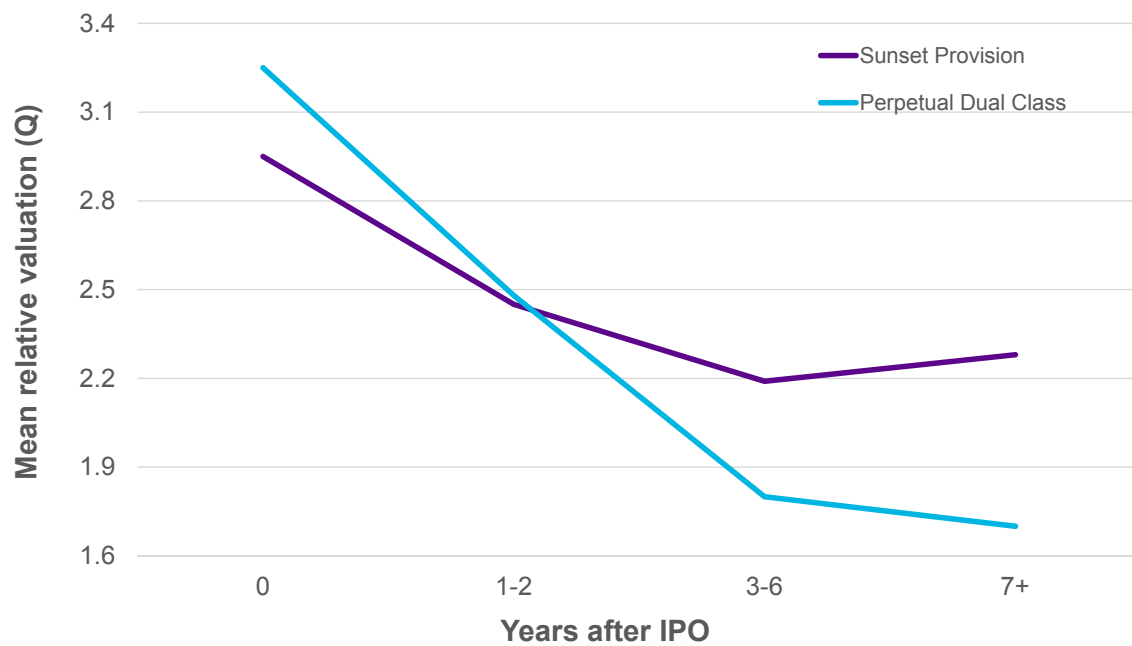


Investor push to change Facebook's shareholder voting rights



Sources: Facebook, Financial Times

Everything has an expiry date



Source: Jackson, R.T (2018): Perpetual dual-class stock: the case against corporate royalty

03 Investors, unite!

The best forms of protection

Investors

- Perform thorough due diligence
- Demand additional safeguards
- Exercise active ownership
- Beware of the hype

Regulators / standard setters

- Make time-based sunsets mandatory
- Ensure effective surveillance and enforcement
- Consider establishing mechanisms for investors to seek recourse
- Promote awareness and investor education

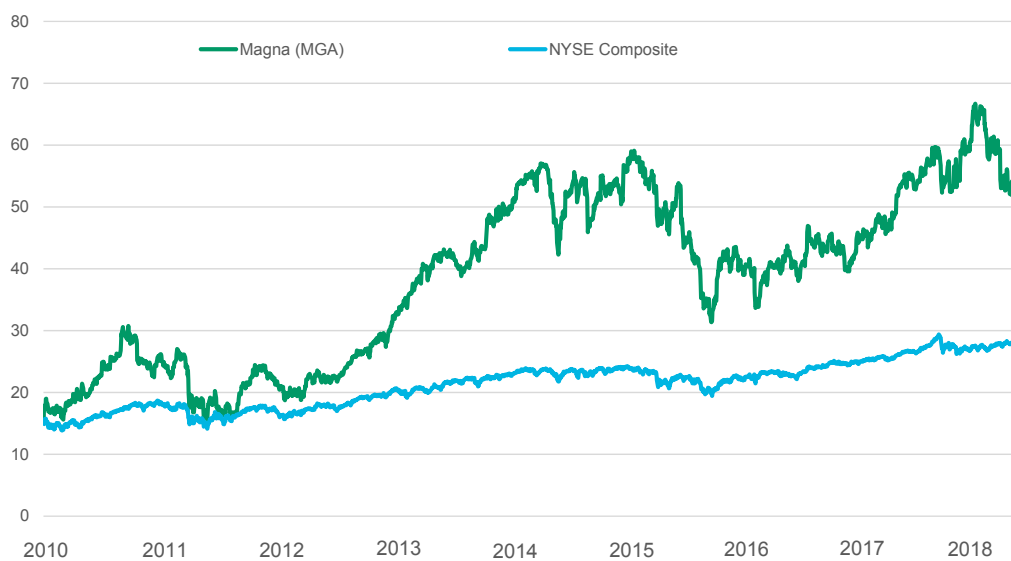
The role of index providers

	Status of consultation	Admission of new DCS companies	DCS companies already listed
S&P Dow Jones	Completed	Not allowed	Grandfathered
FTSE Russell	Completed	Only if >5% of voting rights are held by other shareholders	Grandfathered unless < 5%
MSCI	Completed	No change	No change
Hang Seng Indices	Completed	Allowed, weighting capped at 10%	N/A

Source: Council of Institutional Investors, CFA Institute

04 Case studies

Case study: Magna



Indexed performance; closing price or index level on 5/5/2010 = 17.125

Source: Factiva, CFA Institute

Case study: Snap



Indexed performance; closing price or index level on 3/2/2017 = 24.48

Source: Factiva, CFA Institute

Case study: Viacom **VIACOM**

Viacom



CBS



Source: Yahoo Finance, CFA Institute

Case study: Zynga



Source: Factiva, CFA Institute

APPENDIX A

CFA Institute APAC survey on dual class shares safeguards

About the survey

Research Objective

- Gathering views from CFA Institute charterholders in Asia Pacific on the appropriate safeguards in the likely scenario that DCS is introduced

Survey Response

- The survey was conducted from 8 March to 16 March 2018
- 28,334 members in Asia Pacific were invited to respond
- 454 members responded, for an overall response rate of 1.6% and a margin of error of $\pm 4.6\%$ at a 90% confidence level

Overview of survey questions

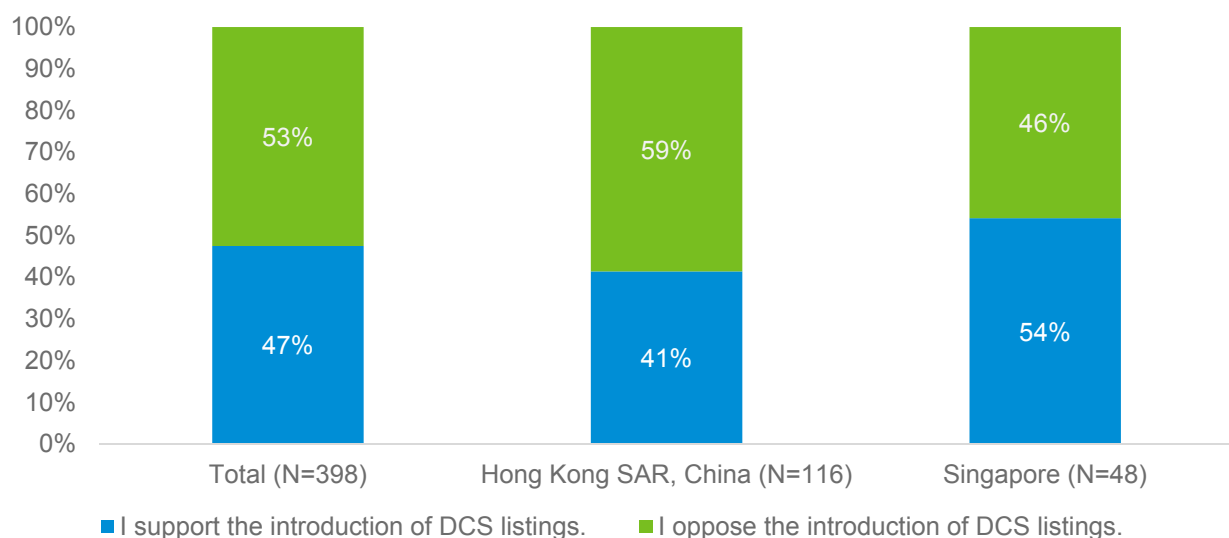
1. Opinion on DCS (support or oppose)
2. Key opportunities and risks brought about by DCS
3. Whether additional safeguards are needed if DCS are introduced
4. Appropriateness of specific safeguards:
 - (a) Mandatory corporate governance measures
 - (b) Sunset provisions
 - (b) Voting rights differential
 - (c) Specific admission criteria
 - (d) Others

Result highlights

- Respondents across APAC are split on the introduction of DCS listings
- Regardless of whether respondents supported DCS, 97% of respondents believe additional safeguards are necessary
- The most appropriate safeguards include:
 - (a) Mandatory corporate governance measures (96-97%)
 - (b) Time-based sunset (94%)
 - (c) Setting a maximum voting right differential (93%)
 - (d) Setting a coat-tail provision (97%)
 - (e) Reverting to one-share one-vote for related party or substantial transactions (93%)

Opinion on DCS

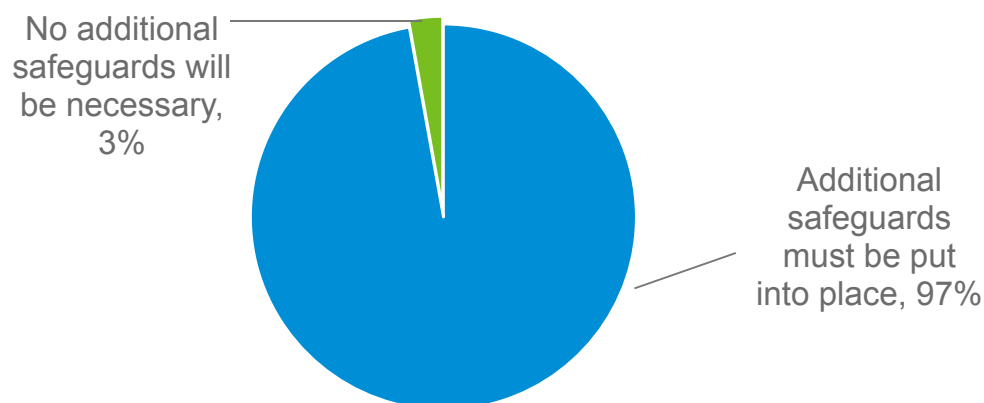
What is your opinion on the introduction of DCS listings to the market you primarily cover and/or are based?



NOTE: Excludes no opinion

Are additional safeguards needed?

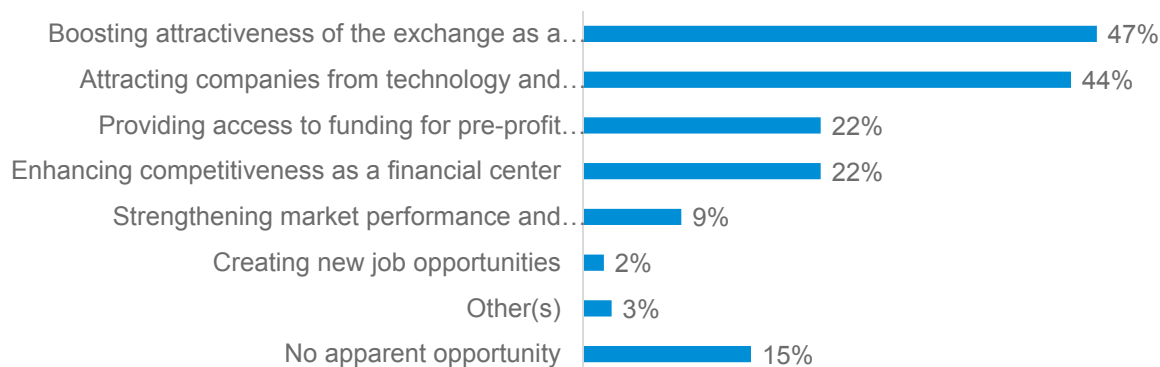
If DCS structures are introduced to the market ...
(N=423)



NOTE: Excludes no opinion

Key opportunities and risks (1/2)

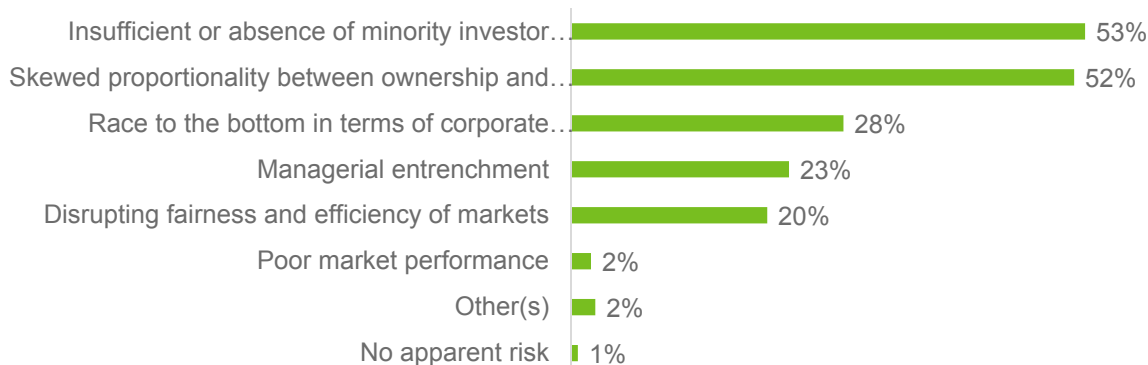
What do you consider as the key opportunities with the introduction of DCS listings?
(N=427)



NOTES: (1) Numbers may not add up to 100% due to rounding ; (2) Excludes no opinion

Key opportunities and risks (2/2)

What do you consider as the key risks with the introduction of DCS listings?
(N=442)



NOTES: (1) Numbers may not add up to 100% due to rounding ; (2) Excludes no opinion

Appropriateness of safeguards (1/3)

		Should be required	Somewhat appropriate	Not appropriate
(A) Mandatory corporate governance measures	Separation of CEO and Chairman roles (N=386)	71%	26%	3%
	Majority of independent directors on the board (N=395)	72%	25%	4%
	Composition of some/all of the key committees to be at least made up of mostly independent directors (N=395)	70%	27%	3%
	The key committees to be chaired by independent directors (N=392)	68%	29%	3%
(B) Sunset provisions	Introducing a time-based sunset clause (N=343)	49%	45%	6%
	Automatic conversion of higher voting right shares to ordinary shares when they are traded (N=364)	59%	33%	9%
	Automatic conversion of higher voting right shares to ordinary shares if/when the DCS beneficiary dies or ceases to be a director for personal/regulatory reasons (N=362)	65%	29%	6%
	Forbidding sunset clauses to be overridden by the controlling shareholder (N=339)	70%	22%	8%

Appropriateness of safeguards (2/3)

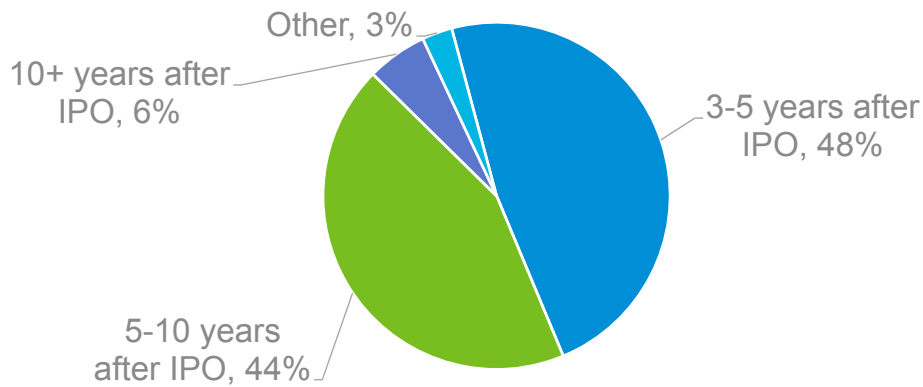
		Should be required	Somewhat appropriate	Not appropriate
(C) Classes of shares / voting right differential	Introducing a maximum voting differential (N=356)	66%	28%	7%
	Prohibiting the issuance of shares with no voting rights (N=361)	50%	27%	24%
	Prohibiting the issuance of dual- or multiple-share classes by a company that is already listed (N=357)	55%	27%	18%
(D) Specific admission and investor Requirement	Setting a minimum market capitalization threshold (N=340)	44%	40%	16%
	Setting a requirement for the listed firm to have been substantially invested by institutional investors, who would have undertaken proper due diligence (N=336)	35%	46%	19%

Appropriateness of safeguards (3/3)

		Should be required	Somewhat appropriate	Not appropriate
(E) Others	Introducing a coat-tail provision, which will allow ordinary shareholders to have an equal footing in the case of a company takeover offer (N=348)	68%	29%	3%
	Reverting to “one share, one vote” for related parties or substantial transactions (N=360)	65%	28%	7%
	Only allowing natural person to hold shares with super voting rights (i.e. no corporate shareholders) (N=342)	43%	30%	27%
	Requiring DCS stocks to contain specific stock codes as identifiers (N=345)	72%	24%	4%
	Establishing a separate board for the listing of such stocks (N=315)	32%	37%	31%
	Prohibiting DCS stocks to be included in major benchmark indices (N=332)	37%	30%	33%

Length of sunset

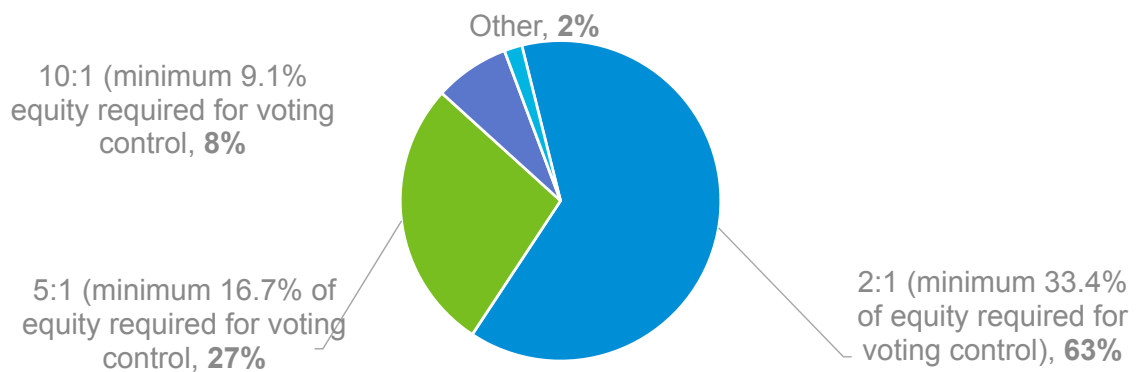
Which one of the following time-based sunset provisions do you consider as optimal?
(N=284)



NOTES: (1) Numbers may not add up to 100% due to rounding ; (2) Excludes no opinion

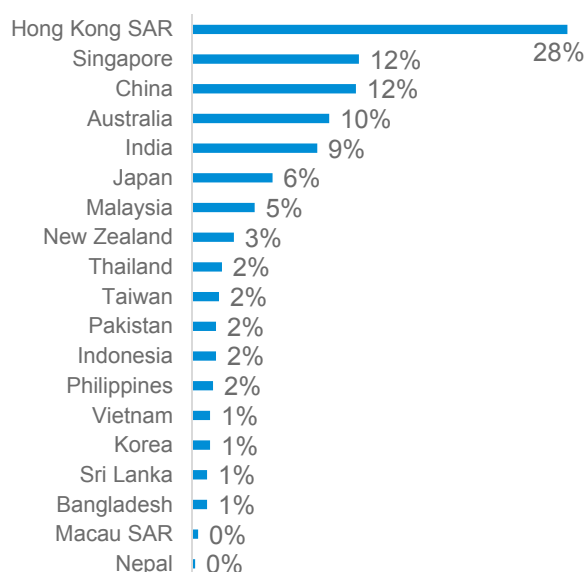
Maximum voting differential

Which one of the following maximum voting differentials do you consider as optimal?
(N=277)



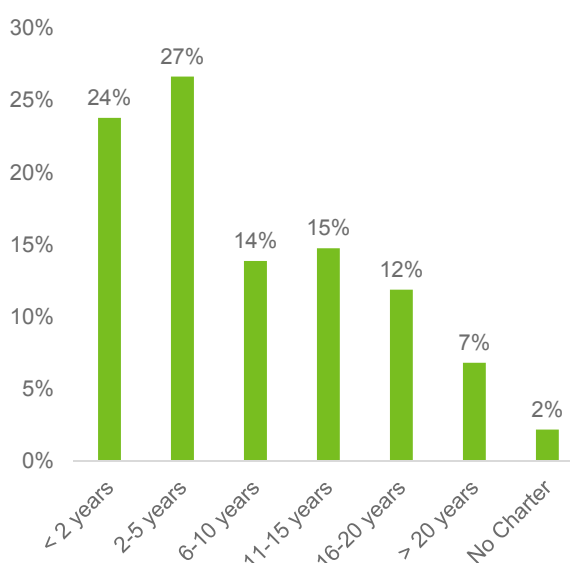
Respondent distribution

Geographic location



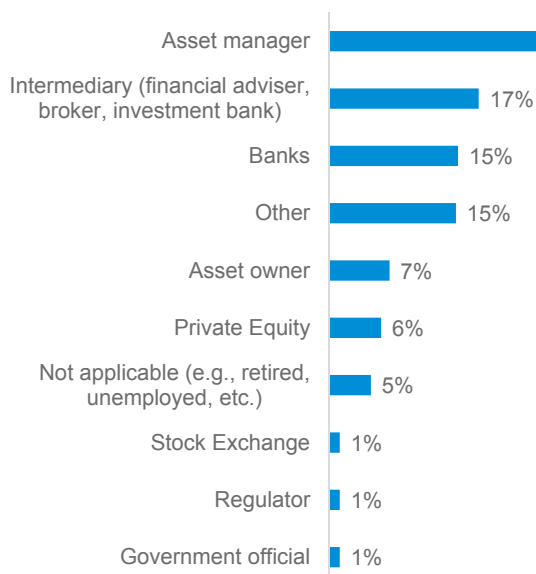
NOTE: Numbers may not add up to 100% due to rounding

Years with the CFA charter



Employer type and occupation

Employer type



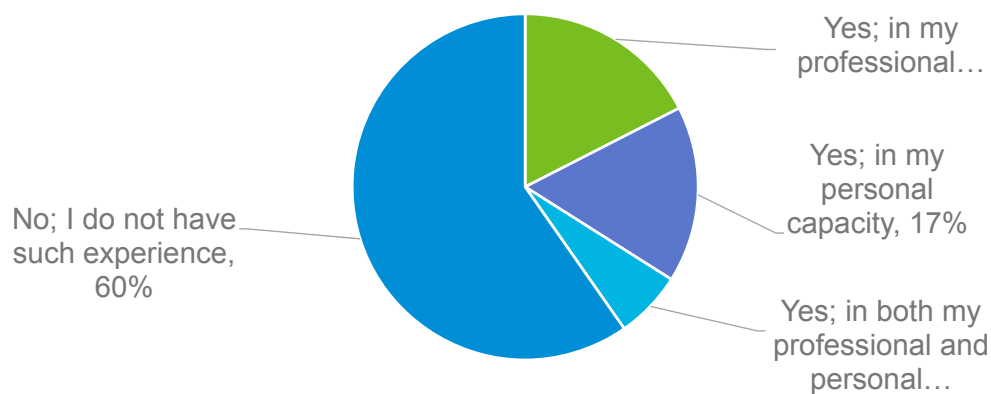
Current occupation



NOTE: Numbers may not add up to 100% due to rounding

Respondent experience in investing

Do you have any experience, in your professional or personal capacity, in investing in equities with dual- or multiple-class share structures?
(N=412)



NOTE: Numbers may not add up to 100% due to rounding