Dual class shares and the need for safeguards

April 2018
About the survey

Background

• Key stock exchanges in Asia Pacific (e.g. Hong Kong and Singapore) are moving towards allowing companies with dual class shares (DCS)* structures to list.

• A DCS structure permits the issuing of different classes of shares with differential voting rights and dividend payment arrangements by the same company.

• Such a structure allows entrepreneurs to maintain control of their companies even after successive rounds of financing.

• It is often considered by academics as an anti-takeover device.

Research Objective

• To gather views from CFA Institute members in Asia Pacific on the appropriate safeguards in the likely scenario that DCS is introduced

Survey Response

• The survey was conducted from 8 March – 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 ± 4.6% at a 90% confidence level.

* DCS is sometimes known as “shares with weighted voting rights” or “shares with unequal voting rights” in other jurisdictions and in the literature
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
   (c) Voting rights differential
   (d) Specific admission criteria
   (e) Others
Summary of survey results

• Respondents across APAC are split on the introduction of DCS listings
  - Respondents in Singapore are more inclined to support while those in Hong Kong are more inclined to oppose
• The most recognized opportunities of DCS include:
  - Boosting attractiveness of the exchange
  - Attracting companies from technology and other innovative sectors
• The most recognized risks of DCS include:
  - Insufficient or absence of minority investor protection
  - Skewed proportionality between ownership and control
• 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
Key opportunities and risks (1/2)

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

Boosting attractiveness of the exchange as a landing spot for IPO issuers - 47%
Attracting companies from technology and other innovative sectors - 44%
Providing access to funding for pre-profit companies - 22%
Enhancing competitiveness as a financial center - 22%
Strengthening market performance and investment returns - 9%
Creating new job opportunities - 2%
Other(s) - 3%
No apparent opportunity - 15%

NOTES:
(1) Respondents could select up to two choices.
(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)

- Insufficient or absence of minority investor protection: 53%
- Skewed proportionality between ownership and control: 52%
- Race to the bottom in terms of corporate governance standards: 28%
- Managerial entrenchment: 23%
- Disrupting fairness and efficiency of markets: 20%
- Poor market performance: 2%
- Other(s): 2%
- No apparent risk: 1%

NOTES:
(1) Respondents could select up to two choices.
(2) Excludes no opinion
Whether additional safeguards are needed

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

Additional safeguards must be put into place, 97%

No additional safeguards will be necessary, 3%

NOTE: Excludes no opinion
## Appropriateness of specific safeguards (1/4)

### (A) Mandatory corporate governance measures

<table>
<thead>
<tr>
<th>Measure</th>
<th>Should be required</th>
<th>Somewhat appropriate</th>
<th>Not appropriate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Separation of CEO and Chairman roles (N=386)</td>
<td>71%</td>
<td>26%</td>
<td>3%</td>
</tr>
<tr>
<td>Majority of independent directors on the board (N=395)</td>
<td>72%</td>
<td>25%</td>
<td>4%</td>
</tr>
<tr>
<td>Composition of some/all of the key committees to be at least made up of mostly independent directors (N=395)</td>
<td>70%</td>
<td>27%</td>
<td>3%</td>
</tr>
<tr>
<td>The key committees to be chaired by independent directors (N=392)</td>
<td>68%</td>
<td>29%</td>
<td>3%</td>
</tr>
</tbody>
</table>

### (B) Sunset provisions

<table>
<thead>
<tr>
<th>Measure</th>
<th>Should be required</th>
<th>Somewhat appropriate</th>
<th>Not appropriate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introducing a time-based sunset clause (N=343)</td>
<td>49%</td>
<td>45%</td>
<td>6%</td>
</tr>
<tr>
<td>Automatic conversion of higher voting right shares to ordinary shares when they are traded (N=364)</td>
<td>59%</td>
<td>33%</td>
<td>9%</td>
</tr>
<tr>
<td>Automatic conversion of higher voting right shares if/when the DCS beneficiary dies or ceases to be a director for personal/regulatory reasons (N=362)</td>
<td>65%</td>
<td>29%</td>
<td>6%</td>
</tr>
<tr>
<td>Forbidding sunset clauses to be overridden by the controlling shareholder (N=339)</td>
<td>70%</td>
<td>22%</td>
<td>8%</td>
</tr>
</tbody>
</table>

**NOTES:**
(1) Numbers may not add up to 100% due to rounding.
(2) Excludes no opinion
### Appropriateness of specific safeguards (2/4)

<table>
<thead>
<tr>
<th>Classes of shares / Voting right differential</th>
<th>Should be required</th>
<th>Somewhat appropriate</th>
<th>Not appropriate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introducing a maximum voting differential (N=356)</td>
<td>66%</td>
<td>28%</td>
<td>7%</td>
</tr>
<tr>
<td>Prohibiting the issuance of shares with no voting rights (N=361)</td>
<td>50%</td>
<td>27%</td>
<td>24%</td>
</tr>
<tr>
<td>Prohibiting the issuance of dual- or multiple-share classes by a company that is already listed (N=357)</td>
<td>55%</td>
<td>27%</td>
<td>18%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Specific admission and investor requirement</th>
<th>Should be required</th>
<th>Somewhat appropriate</th>
<th>Not appropriate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Setting a minimum market capitalization threshold (N=340)</td>
<td>44%</td>
<td>40%</td>
<td>16%</td>
</tr>
<tr>
<td>Setting a requirement for the listed firm to have been substantially invested by institutional investors, who would have undertaken proper due diligence (N=336)</td>
<td>35%</td>
<td>46%</td>
<td>19%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Others</th>
<th>Should be required</th>
<th>Somewhat appropriate</th>
<th>Not appropriate</th>
</tr>
</thead>
<tbody>
<tr>
<td>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)</td>
<td>68%</td>
<td>29%</td>
<td>3%</td>
</tr>
<tr>
<td>Reverting to “one share, one vote” for related parties or substantial transactions (N=360)</td>
<td>65%</td>
<td>28%</td>
<td>7%</td>
</tr>
<tr>
<td>Only allowing natural person to hold shares with super voting rights (i.e. no corporate shareholders) (N=342)</td>
<td>43%</td>
<td>30%</td>
<td>27%</td>
</tr>
<tr>
<td>Requiring DCS stocks to contain specific stock codes as identifiers (N=345)</td>
<td>72%</td>
<td>24%</td>
<td>4%</td>
</tr>
<tr>
<td>Establishing a separate board for the listing of such stocks (N=315)</td>
<td>32%</td>
<td>37%</td>
<td>31%</td>
</tr>
<tr>
<td>Prohibiting DCS stocks to be included in major benchmark indices (N=332)</td>
<td>37%</td>
<td>30%</td>
<td>33%</td>
</tr>
</tbody>
</table>

**NOTES:**
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(2) Excludes no opinion
Which one of the following time-based sunset provisions do you consider as optimal? (N=284)

- 3-5 years after the issuance of such share class, 48%
- 5-10 years after the issuance of such share class, 44%
- 10+ years after the issuance of such share class, 6%
- Other, 3%

NOTES:
(1) Shown only to those who think introducing a time-based sunset clause should be required or is somewhat appropriate (94%).
(2) Excludes no opinion
Appropriateness of specific safeguards (4/4)

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

- 10 : 1 (owners of shares with higher voting rights need 9.1% equity stake to have a majority vote), 8%
- 5 : 1 (owners of shares with higher voting rights need 16.7% equity stake to have a majority vote), 27%
- 2 : 1 (owners of shares with higher voting rights need 33.4% equity stake to have a majority vote), 63%
- Other, 2%

NOTES:
(1) Shown only to those who think introducing a maximum voting differential should be required or is somewhat appropriate (93%).
(2) Excludes no opinion
Respondent profile
Respondent distribution

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)

- Yes; in my professional capacity, 17%
- Yes; in my personal capacity, 17%
- Yes; in both my professional and personal capacity, 6%
- No; I do not have such experience, 60%

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