



Investor Coalition for Equal Votes

Undermining the Shareholder Voice

The rise and risks of unequal
voting rights

Executive summary



The right to vote is arguably the most important of all shareholder rights, as it helps align the interests of company management with those of its investors.

In recent years, there has been a significant increase in the number and proportion of initial public offerings (IPOs) that have dual-class share structures. In the three-year period from 2020 to 2022, over 40% of US tech IPOs had dual-class structures, compared to 20% of US non-tech stock IPOs. These proportions are significantly higher than historic averages. For example, in 2019, just 7% of US companies in the Russell 3000 Index had a dual or multiple-class share structure.

Supporters of dual-class share structures argue that they protect the founding shareholders and the other beneficiaries of these super voting rights from the vagaries of the stock market, giving them the opportunity to carry out their vision. However, the material presented in this report – based on a detailed review of the available academic and practitioner literature, combined with an assessment of some of the most high-profile controversies around dual-class share structures – suggests that the increased use of these structures is likely to

harm the interests of long-term investors and, in turn, the interests of the savers and beneficiaries who rely on them. Our research suggests that:

- Any potential financial advantages of dual-class share companies recede over time, usually within a few years of the IPO.
- Dual-class share structures privilege company insiders, giving them power over the company that is, frequently, significantly greater than their economic interest in the company.
- In companies with these structures, there is clear evidence that management and boards are more insulated from the perspective of independent investors – whose views are more closely aligned with the needs of beneficiaries and clients. For example, it is generally more difficult for shareholders to ensure that boards are appropriately structured, to influence company strategy, challenge capital expenditure decisions or access robust financial and other information about the company.

What are dual-class share structures?

Dual-class share structures (also referred to as dual-class stock or unequal voting rights) are equity structures where a company has issued two or more share classes (e.g. Class A and Class B shares), and these share classes differ in terms of voting rights.

When multiple share classes of stock are issued, the class with limited, if any, voting rights is normally offered to the general public. The classes with more voting rights are typically only offered to insiders such as company founders, executives and family members, allowing them to retain control of the company.

ICEV's preference – in line with the views of many long-term investors – is for all companies to have single-class share structures from the date of their public listing.

If companies do adopt dual-class share structures, ICEV believes that these structures should have explicit time-based sunset clauses, with the company reverting to a single-share class after a maximum of seven years from the date of public listing. We also recommend some additional supplemental safeguards –

further details are provided overleaf – to be put in place to protect investors during the period prior to any sunset trigger date, or in the absence of a sunset clause.

For example, legislation recently passed in the US House of Representatives would require multi-class companies to clarify in annual meeting proxy statements the gap between the equity held by each insider (and 5% holder) and the percentage of total voting power they each control.

Our recommendations

Unequal voting rights are an increasingly important issue for the capital markets of several jurisdictions. Considering the detrimental impact of these unequal voting rights on outcomes for individual savers and for capital markets as a whole, we have set out some broad, universally applicable, recommendations.

We believe these should be applied in all markets, and be actively supported by all financial market actors in the following ways.

Companies

- Adopt single-class share structures at IPO or as soon as possible thereafter.
- With any use of dual-class share structures, adopt explicit time-based sunset clauses of no more than seven years from the date of public listing, at which time the company reverts to a single-share class.
- If sunset clauses are not adopted, companies should adopt provisions that require periodic approval, at least every seven years, from a majority of each share class voting separately, for the dual-class share structure to continue.
- Adopt supplemental safeguards for pivotal proposals e.g. those on mergers and acquisitions and board structure, to require support from a simple majority of outstanding shares for adoption at all times, including prior to any sunset trigger date.

Company advisers*

- Fully inform clients contemplating dual-class share structures of the risks associated with such structures and of the reasons why such structures are opposed by long-term investors. We note that this recommendation is in line with advisers' duty to appropriately inform and advise clients as to the institutional investor and wider market perspective.
- Ensure that, where dual-class share structures are used, firms use time-based sunset clauses (maximum seven years) that are embedded in the governing documents prior to IPO.

* Including legal and financial advisers, and investment banks

Stock exchanges and index providers

- Adopt listing standards and methodologies, as applicable, which discourage the adoption of dual-class share structures. Such standards and methodologies are in line with their historic role in upholding basic governance standards in public equity markets.
- Require companies with dual-class share structures, should the decision be made to admit such companies, to have time-based sunset clauses (maximum seven years) or to periodically obtain majority approval from each class – voting separately – for the dual-class share structure to continue.
- Ensure that any dual-class companies they admit to listing or index inclusion are clearly identified as having dual-class share structures.

Investors

- Publicly oppose dual-class share structures, and adopt formal advocacy, engagement and voting policy decisions to that effect.
- Work with policymakers, stock exchanges and index providers to adopt policy measures that discourage the adoption of dual-class share structures, and to ensure that companies with these structures work with policymakers, stock exchanges and index providers to adopt policy measures that discourage the adoption of dual-class share structures, and to ensure that companies with these structures have incorporated the safeguards we mention on [page 2](#).
- Engage with pre-IPO companies and their advisers to explain why equal voting rights are in line with the company's long-term best interests, and how equal voting rights powerfully signals a company's willingness to work in partnership with the owners of capital.
- Use all stewardship tools at their disposal to urge companies with existing dual-class share structures to explore the benefits of recapitalisation to restore equal voting rights, whether in the near or medium-term via time-based sunset clauses (a maximum of seven years from the date of the IPO).



Policymakers and regulators

- Recognise the evidence on the negative impacts of dual-class share structures on individual savers and take steps to discourage companies from listing with these structures, unless it is with a time-based sunset clause (seven years or less from IPO) and includes robust investor protections as outlined on [page 2](#).
- Take interim steps, in advance of more comprehensive market reforms, towards enhancing transparency from companies that list with dual-class share structures. This includes requiring these companies to do the following:
 - Disclose the numerical relationship between 'ownership interests' and the amount of voting rights held or controlled by such a person (voting rights), for all entities with significant ownership interests and/or unequal voting rights.

- Report shareholder meeting results in a way which delineates between the votes of those individuals or entities with differential voting rights.
- Specifically disclose the risk that those with weighted voting rights could use them to approve governance changes that would further increase any disparity between the ownership interests and voting rights held by such persons. This should include a description of the measures taken to prevent this occurring.
- Prominently display the fact that the share class structure is not a one share, one vote structure in IPO documents, prospectuses and other legal documentation.

Time-based vs ownership-based sunset provisions

In general, ownership-based sunset provisions automatically trigger conversion to equal voting rights for all shareholders if the founder's position falls below a designated percentage of outstanding voting power, common shares or shares of a specific class. The threshold typically specified by these provisions is 5% or 10% of outstanding common shares.

Like a time-based provision, an ownership-based sunset is embedded within a company's governing documents at the time of the IPO. Both provisions thus enshrine the conditions for an 'automatic sunset' but only one is guaranteed to deliver equal voting rights.

By controlling board composition and the outcome of any board-approved shareholder vote on future stock issuances, the founder who is subject to a standalone ownership-based sunset retains nearly total control over whether, and when, the company converts to a one share, one vote structure.

For this reason, many investors view ownership-based sunset provisions as potentially worthwhile supplements to time-based provisions, but ineffective as a standalone solution. The clear exception to this would be a provision triggering conversion upon the founder's stake falling below a majority of outstanding common shares.

To find out more about the Investor Coalition for Equal Votes (ICEV) and this report, visit the Coalition's page (pending the launch of ICEV's own website) on Railpen's website at railpen.com/knowledge-hub/our-thinking/2023/icevone-share-one-vote-1/ or email SO@railpen.com

