RESPONSIBLE INVESTMENT

Class inequality: the disparity between share ownership and voting power

A dual class share structure, also known as a multi-class, results in certain shareholders enjoying superior voting rights compared to ordinary shareholders. This unequal distribution often leads to shareholders with inferior voting rights being disadvantaged and effectively disenfranchised. Given the right to vote is arguably the most important shareholder privilege, the fairness of dual class share structures remains highly contentious.

In recent years, dual class share structures have become much more common, attracting increased shareholder scrutiny. This trend is evident in our recent voting activity, especially in the US and EU markets. While not necessarily common, within our voting universe, most companies operating with dual-class share structures are either founder-led technology companies or majority family-owned.

- European Union: The prevalence of dual class share structures varies significantly across Europe. In Western Europe, almost half of all companies have some form of unequal voting rights, while in the Nordic region, nearly a third of companies have them. In Southern Europe, only 12% of businesses have such structures.
- United States: Approximately 7% of companies in the Russell 3000 Index have a dual or multi- class structure.
- United Kingdom: Dual class share structures are relatively rare, with only about 4% of companies operating them[1].

Advocates of dual class share structures argue that when a company goes public, such a structure can defend it from outside influence allowing the company to focus on long-term innovation. This can be particularly beneficial for innovative technology companies that require stability and expertise to execute their vision. However, these structures can also lead to governance concerns as they may limit the influence of ordinary shareholders and potentially lead to decisions that do not align with the broader shareholder base. The lack of accountability and transparency can be a significant drawback, raising questions about fairness and investor protection.

UK

Traditionally, the 'one-share-one-vote' philosophy underpins UK corporate governance and is essential in protecting investors rights. The premise is simple; with a single share class, all investors have equal rights proportionate to their share ownership. This logic has largely gone unchallenged, that is, until the Financial Conduct Authority introduced recent regulatory changes, which lifted long-standing regulations supporting these single share voting structures. Previously, preferential voting rights held by individuals were subject to a ten-year sunset provision (the deadline to which the dual-class shares convert to ordinary shares). Under the new listing rules, this is no longer the case. This transition from the 'one share, one vote' model serves to align with the practices of the US and EU. Notably, the proposals are viewed as an effort to attract more companies, especially in the technology sector, to the London

1 Dual Class Share Structures: The European Experience

Stock Exchange, which has seen a 40% decline in the number of listed companies since 2008.[2] Critics of this change highlight it undermines UK corporate governance principles; however, this move is intended to make the UK market more attractive to list and remain competitive on a global scale.

EU

The general consensus across the EU is positive when approaching dual-class share structures and in recent years the 'one-share-one-vote' principle has relaxed across the region. For example, both France and Belgium employ loyalty voting rights: *'multiple voting rights for shareholders who have held their shares for a certain period.'*[3] In an effort to combat corporate short-termism, some advocate for loyalty voting rights as a way to balance traditional dual class voting rights with ordinary voting rights. These structures enable shareholders to gain preferential voting rights without additional costs. Furthermore, founder-led companies, which often benefit from such structures, can maintain control, and avoid challenges through contested board elections.

Our proxy advisor's (ISS) recommendation deviates from this largely positive take on dual class structure, taking a more traditional approach of recommending voting against agenda items in instances of dual class share structures; both the creation and continuation of such. We tend to vote against the re-election of directors at meetings where certain directors benefit from dual class share structures where there is not a timeline for the shares with superior voting rights to convert to ordinary shares. In the rare occasions, we will support the item, as demonstrated below.

At the 2023 AGM, our proxy advisor recommended voting against the re-election of several directors due to the dual voting rights not being subject to expire on a pre-determined expiry date. In this instance, the company highlighted that one shareholder holds the majority of voting rights, and the board does not have the ability to change the current voting structure. As a result, voting against the directors would have been largely ineffective.

US

In the United States, dual class share structures are used by some companies to maintain centralised control while also accessing public capital. These structures typically involve two classes of shares: one with enhanced voting rights (often held by founders and executives) and another with limited or no voting rights (usually offered to the public).

Similar to European markets, our proxy advisor has a strong preference for a single class of common stock, however there are exceptions. ISS may support the presence of a dual class share structure in instances where there will be little to no dilution of current shareholdings and the voting power of a significant/ group of significant shareholders will not be increased.[4] While we assess each instance on a case-by-case basis, we are generally supportive of this position.

At the 2024 AGM, we opposed the re-election of several directors as the company continues to maintain a multi-class share structure without a reasonable sunset provision. Established in 2004, Alphabet is well-acquainted with dual class share structures, and indeed has three share classes, including Class C shares that carry no voting rights. While we recognise the benefits of companies going public with a dual class share structure, we generally vote against such arrangements unless the company provides a clear timeline for converting preferential shares to ordinary shares.

2 Governance Explainer - Dual-class shares | Blogs | IoD
3 Why loyalty voting rights and dual class shares should coexist | ECGI
4 US-Voting-Guidelines.pdf

Is the sun setting too slowly?

Sunset provisions outline the process and, occasionally, the timing for terminating dual class share structures and converting all shares into a single class. As already noted, the presence of multi-class share structures can benefit companies at the time of initial public offering (IPO) and in the short-term thereafter, but in our view the benefits across the long-term decline sharply. Noticeably, the presence of entrenched management, poor corporate governance practices and reduced accountability, all of which negatively impact ordinary shareholders.

A study from the European Corporate Governance Institute provides evidence that, even in innovative companies where multi-class structures correlate to a value premium at the time of the IPO, that premium dissipates within six to nine years before turning negative.[5] Therefore, the consensus seems to promote setting a sunset provision of ten years, at which point dual classes will be converted to single shares.

LVMH *We voted against the re-election of several directors at this year's meeting due to the company maintaining a multi-class share structure. While less than 50% of the company is family owned, this equates to over 65% of voting rights. Notably, the structure is not sunset based, raising concerns that ordinary shareholders will be negatively impacted over the long-term.*

Conclusion

Broadly speaking, the approach to dual class share structures has softened in recent years. While most evident in the updated UK listing rules, Australia and Belgium are countries that have completely banned the structure entirely. Canada, China, and Hong Kong also adopt a restrictive model. Given the fierce competition for businesses and investments, financial centres must ensure that regulators regularly review and update regulations to maintain a business-friendly environment.

Given the varying market approaches to dual class share structures, a one size fits all approach is not suitable. As financial markets evolve and face increasing competition, regulators and exchanges must balance the benefits of attracting high-growth companies with the need to maintain robust governance standards. Sunset provisions and regular reviews of dual class share structures can help mitigate some of the associated risks, ensuring that these frameworks remain fair and beneficial for all stakeholders involved.

When assessing our voting approach regarding multi-class share structures, we consider local market regulations and best practices. Ultimately, the future of dual class share structures hinges on how effectively these competing interests are managed. Our overall perspective still favours an equal share structure, as we believe this benefits the majority of shareholders in the long term.

Kirsty Ward
Responsible Investment Analyst

5 PS24/6: Primary Markets Effectiveness Review: Feedback to CP23/31 and final UK Listing Rules

Quilter Cheviot
Senator House
85 Queen Victoria Street
London EC4V 4AB
+44 (0)20 7150 4000

To find out more please contact your investment manager or email: marketing@quiltercheviot.com

quiltercheviot.com

This is a marketing communication and is not independent investment research. Financial Instruments referred to are not subject to a prohibition on dealing ahead of the dissemination of marketing communications. Any reference to any securities or instruments is not a personal recommendation and it should not be regarded as a solicitation or an offer to buy or sell any securities or instruments mentioned.

Investors should remember that the value of investments, and the income from them, can go down as well as up and that past performance is no guarantee of future returns. You may not recover what you invest.

QUILTER CHEVIOT

SPECIALISTS IN INVESTMENT MANAGEMENT

(12/2024)