Corporate Governance and Dual-Class Shares: Who's in Control?

In this paper, we discuss the rise in concentrated ownership of publicly listed companies and the increasing prevalence of dual-class share structures, which allow company founders and insiders to maintain control with a minority of a company's share capital. We highlight the growing number of jurisdictions allowing the issuance of multiple-vote shares, departing from the 'one share, one vote' proportionality principle. We also touch on the existing control enhancement mechanisms, such as multiple equity classes with unequal voting rights, control via pyramid and cross-ownership structures, and single equity classes with unequal voting rights. Finally, we profile the Lazard Global Governance Principles and Proxy Voting Policy, which favours democratic shareholder rights and the 'one share, one vote' principle.

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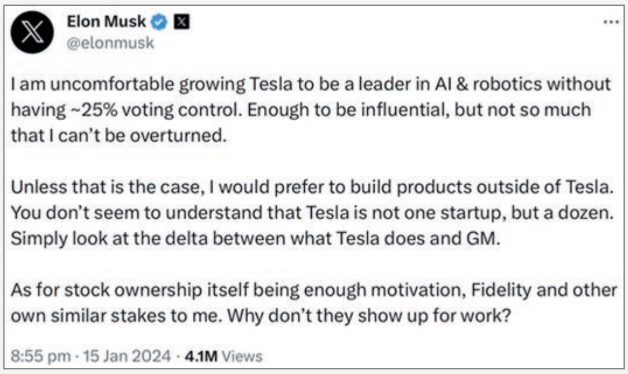
Elon Musk Wants Voting Control

Earlier this year Elon Musk stated on a quarterly earnings call and posted on his social media platform X that he favours a dual-class share structure to achieve his goal of securing 25% voting control of Tesla Inc. (Exhibit 1). His demand for multiple-vote shares to reach the 25% control mark met with plenty of investor opposition, with the technology visionary being told it was impossible after the electric car-maker's initial public offering (IPO).

Exhibit 1
Post on Social Media Platform X by Elon Musk


Elon Musk
@elonmusk

I am uncomfortable growing Tesla to be a leader in AI & robotics without having ~25% voting control. Enough to be influential, but not so much that I can't be overturned.

Unless that is the case, I would prefer to build products outside of Tesla. You don't seem to understand that Tesla is not one startup, but a dozen. Simply look at the delta between what Tesla does and GM.

As for stock ownership itself being enough motivation, Fidelity and other own similar stakes to me. Why don't they show up for work?

8:55 pm · 15 Jan 2024 · 4.1M Views

As at 15 January 2024
Source: X

Exhibit 2
High-Profile Examples of Dual-Class Share Structures

Company	Controlling Shareholder(s)	Economic Interest in the Company (approx.)[a] (%)	Voting Rights of Individual(s) (approx.) (%)
Alphabet	Sergey Brin and Larry Page	12	51
Designer Brands	Schottenstein Family	23	57
Meta	Mark Zuckerberg	13	61
News Corp	The Murdoch Family	14	39
Snap Inc	Evan Spiegel and Bobby Murphy	44	96
Zillow	Rich Barton and Lloyd Frink	20	52

As at 30 November 2023
[a]Measure: Percentage by value of issued share value.
Mention of these securities should not be considered a recommendation or solicitation to purchase or sell the securities. It should not be assumed that any investment in these securities was, or will prove to be, profitable, or that the investment decisions we make in the future will be profitable or equal to the investment performance of securities referenced herein, or that securities sold have not been repurchased. The securities mentioned may not represent the entire portfolio.
Source: Investor Coalition for Equal Votes: "Undermining the Shareholder Voice – The Rise and Risks of Unequal Voting Rights"

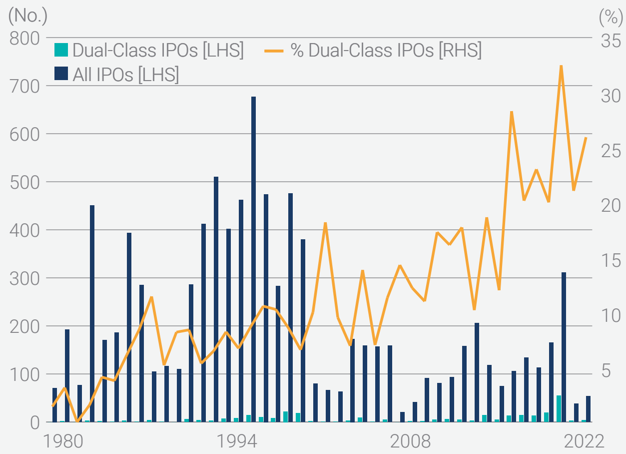
What is a Dual-Class Share Structure?

The dual-class share structure is a controversial topic within the world of corporate governance. It refers to a company's common equity being divided into different classes of shares, typically with one class (Class A) having one vote per share and another class (Class B) having multiple votes per share. This structure allows company founders and insiders—like technology figureheads Mark Zuckerberg, Sergey Brin, and Larry Page—to maintain control of a company with a minority of its share capital (Exhibit 2).

Dual-Class Share Structure IPOs

In the US, there has been a significant increase in the number and proportion of IPOs featuring dual-class share structures, especially in the technology sector (Exhibit 3).

Exhibit 3
Dual-Share Class Structure IPOs in the US



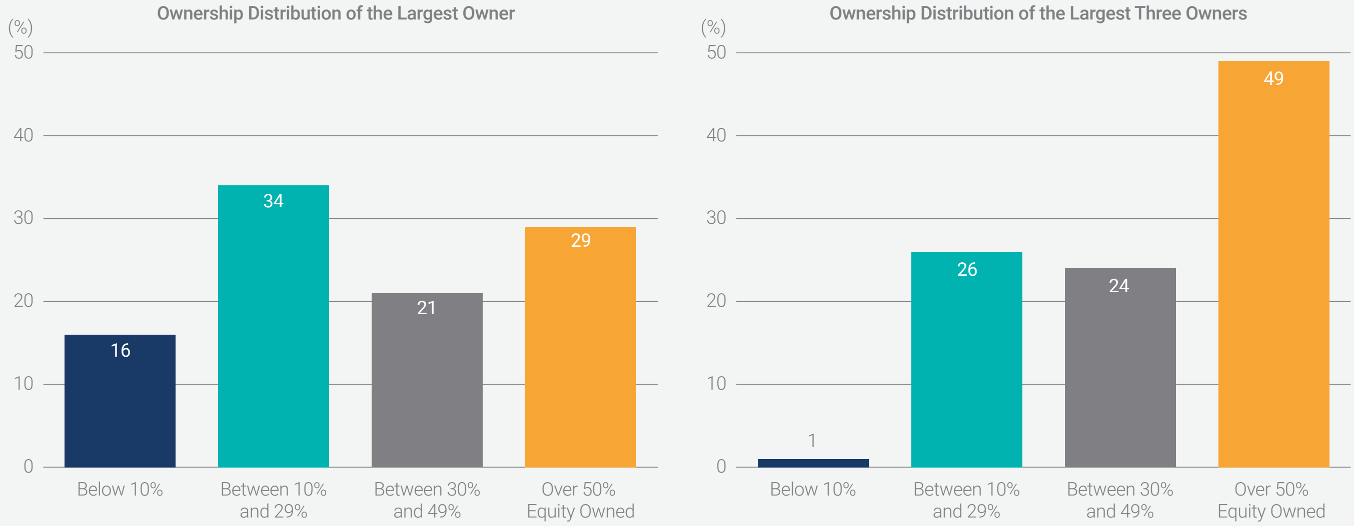
As at 31 December 2023
Source: Jay R. Ritter – "Initial Public Offerings: Dual Class Structure of IPOs Through 2023" - IPOs-DualClass (ufl.edu)

Concentrated Ownership on the Rise

According to researchers at the London Business School,[1] globally about 44% of listed companies are ultimately controlled, with 56% classified as widely held.[2] Fully dispersed corporate ownership—where the three largest shareholders hold less than 10% of a company's equity capital—is a rare phenomenon, accounting for only 1% of listed companies worldwide.[3] Controlled corporate ownership is far more common, with almost 85% of the world's largest listed companies having a single shareholder holding more than 10% of the company's capital (Exhibit 4). The three largest shareholders hold more than 30% of the capital in three quarters of all listed companies and above 50% of the capital in half of the listed companies worldwide.

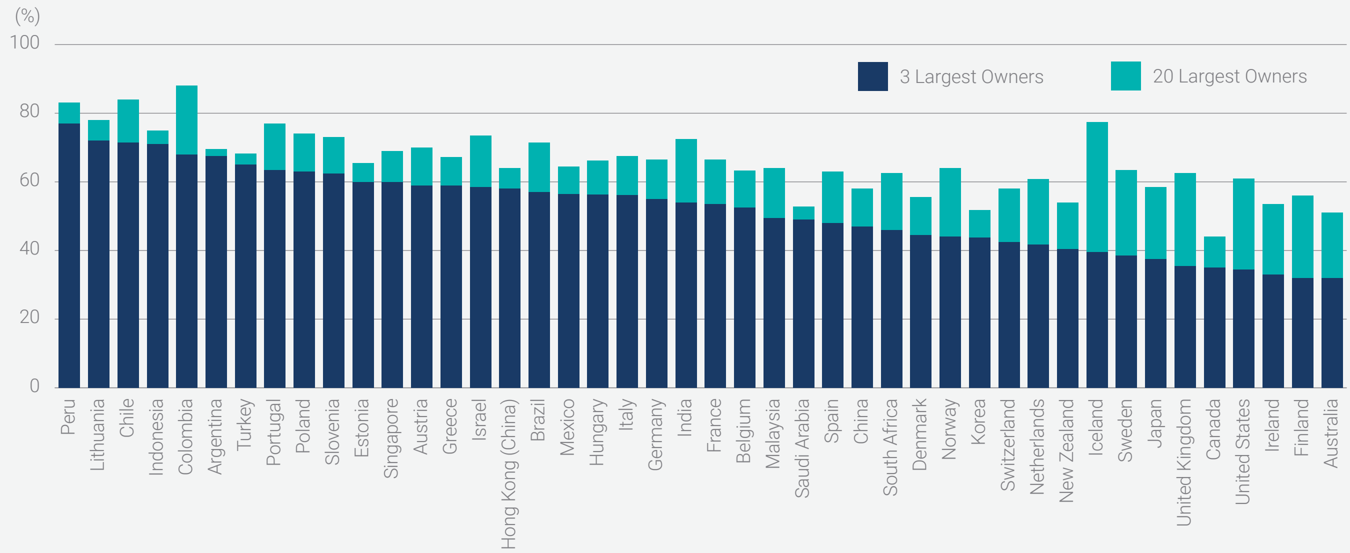
The increasing importance of Asian companies in equity markets, a growing amount of funds flowing into a decreasing number of companies, and the partial privatisation of many state-owned companies through stock market listings have shifted ownership structures towards more concentrated ownership models (Exhibit 5).[4]

Exhibit 4
Ownership Concentration Distribution



As at 31 December 2017
Source: OECD 'Owners of the World's Listed Companies'. October 2019

Exhibit 5
Ownership Concentration by Market



As at 31 December 2022
Source: OECD, 'Corporate Governance Factbook 2023'

Control Enhancement Mechanisms

Beyond the abovementioned ownership concentration, there are many control-enhancing mechanisms used by publicly listed companies. These include multiple equity classes with unequal voting rights, control via pyramid and cross-ownership structures, and single equity classes with unequal voting rights.

- Multiple equity classes with unequal voting rights (e.g. preference shares, dual-class share structures): This structure allows companies to issue shares with different (or zero) voting rights, enabling founders or controlling shareholders to maintain control while raising capital from public investors.[5]
- Control via stock pyramid: Control is exercised through a chain of controlled companies. In this structure, a parent company owns a majority stake in a subsidiary, which in turn owns a majority stake in another subsidiary, and so on. This allows the controlling shareholder to maintain control over multiple companies with a relatively small investment.
- Cross-ownership structures: Companies linked by horizontal cross-holdings of shares. This can reinforce and entrench the power of central controllers by reducing the amount of equity that a shareholder has to invest to acquire, maintain, or defend control. This structure can also lead to the separation of cash flow rights from voting rights, similar to stock pyramids.
- Single equity class with unequal voting rights (e.g. loyalty shares): Companies issue shares with different voting rights based on factors such as the length of time the shares have been held. This allows long-term shareholders to have more voting power and control over the company.[6]

The Rise in Jurisdictions Allowing Dual-Class Shares

Several countries around the world, including the US, Sweden, and the Netherlands, allow companies to go public with dual-class share structures without imposing significant restrictions (Exhibit 6).

Exhibit 6
Regulatory Approaches to Dual-Class Shares around the World

Regulatory Approach	Jurisdictions (examples)
Bans	Australia, Belgium, Brazil (Novo Mercado), Colombia, Ecuador, Germany, Malaysia, Poland, Spain
Permissive approach	Netherlands, Sweden, US
Restrictive model	Canada, China, Hong Kong, India, Singapore, UK

As at 31 March 2024
Source: Lazard, European Business Organisation Law Review

Recently there has been a significant increase in jurisdictions allowing companies to issue multiple-vote shares, departing from the 'one share, one vote' proportionality principle. Regulatory competition to attract IPOs has led many jurisdictions to revise their regulatory approaches to dual-class shares structures. This has been the case for various Asian financial centres, including Hong Kong (2018), Singapore (2018), Shanghai (2019), and India (2019).

In 2021, the UK revised its Listing Rules to allow dual-class share structures on the premium tier of the London Stock Exchange in order to attract more companies, particularly high-growth tech firms.[7] In addition, similar proposals were contained in the European Listing Act.[8]

The optimal regulatory model to deal with dual-class share structures depends on a variety of local factors. Generally, it can be argued that in countries with sophisticated markets and regulators, robust legal protection for minority investors, and low private benefits of control, regulators should allow companies to go public with dual-class share structures with no restrictions or minor regulatory intervention. For example, in Sweden, where dual-class share structures are common, owners are highly engaged and minority shareholder protection is strong.

Lazard's Global Governance Principles and Proxy Voting Policy

As incorporated in the Lazard Global Governance Principles, we favour democratic shareholder rights, i.e. voting rights that are proportionate to shareholders' economic participation in companies (the 'one share, one vote' principle).[9] The divergence of voting rights from cash flow rights can exacerbate agency problems and may entrench management.

For example, in the US, we generally support shareholder proposals that provide all shareholders with equal voting rights ('one vote per share'). Although these proposals are often fully supported by minority shareholders, they never pass given the voting rights of the controlling shareholder.

In addition, we would be in favour of voting against the chair of the governance committee where such structures are in place without a disclosed plan to sunset the arrangement. A sunset arrangement is important, as the potential financial advantages of dual-class share structures for companies, if they exist, tend to recede over time.[10]

Public Policy Engagement

As an active member of the Global Governance Committee of the International Corporate Governance Network (ICGN), we also recently helped develop governance recommendations for the US.[11] These included a recommendation related to multi-class share structures, including the support for enhanced disclosure (e.g. H.R. 2795 – Enhancing Multi-Class Share Disclosures Act).[12]

Meanwhile in the UK, the Financial Conduct Authority is in the process of reforming the UK's listing regime. We are particularly concerned by the introduction of a more permissive approach to dual-class shares structures—with few shareholder protection safeguards—and the removal of shareholder votes prior to significant transactions and related-party transactions.

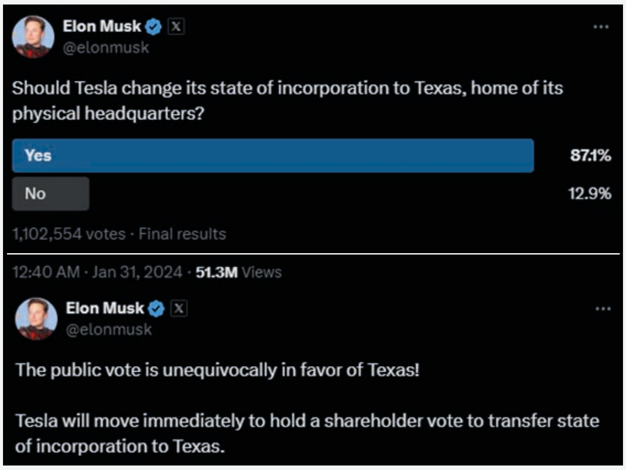
Back to Elon Musk and Control of Tesla

At this year's AGM in June, Tesla Inc.'s shareholders are being asked to approve a proposal to move Tesla's state of incorporation from Delaware to Texas and ratify the 2018 stock option award to Elon Musk. These proposals are a direct result of a decision by the Delaware Court earlier this year to rule in favour of the plaintiff, Richard J. Tornetta, in a derivative lawsuit against Tesla's directors for awarding Musk a performance-based equity-compensation plan.[13]

After this Delaware Court ruling, Musk posted on X a poll asking if Tesla should move its registration from Delaware to Texas, where it is already headquartered. Hours later, the Tesla CEO wrote: *"The public vote is unequivocally in favor of Texas! Tesla will move immediately to hold a shareholder vote to transfer state of incorporation to Texas."* A Texas move won the backing of more than 87% of the 1.1 million public votes (Exhibit 7).

Interestingly, the Texas reincorporation also includes the possible creation of a separate class of preference shares, with the board having explicit powers to determine all characteristics of these shares as and when issued, including voting rights (Tesla currently only has one share class). Watch this space.

Exhibit 7
Posts on Social Media Platform X by Elon Musk



As at 31 January 2024
Source: X

Conclusion

The rise in concentrated ownership and dual-class share structures has sparked debate in the world of corporate governance. While these structures can help founders and insiders maintain control, they can also exacerbate agency problems and entrench management.

As more jurisdictions allow the issuance of multiple-vote shares, it is crucial to strike a balance between attracting IPOs and protecting minority shareholders. The optimal regulatory model depends on local factors, such as market sophistication, legal protection for minority investors, and private benefits of control. Companies and regulators must carefully consider these factors when implementing dual-class share structures and control enhancement mechanisms.

About the Author

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Roland M. Bosch is a Governance Analyst on the Sustainable Investment and ESG team. Prior to joining Lazard in 2022, Roland was a senior investment stewardship specialist with Federated Hermes International, where he was sector lead for financial services and responsible for corporate engagements in Europe and the US. Prior to joining Federated Hermes, he worked as an investment manager at F&C Asset Management, where he was responsible for managing institutional equity portfolios, as well as providing investment analysis and recommendations. Before that, Roland was based in the Netherlands, working as an investment manager for insurance group Achmea and as an equity analyst at HSBC James Capel. Roland is a certified investment analyst (RBA), EFFAS financial analyst and holds a master's degree in Business Economics from University of Groningen.

This content represents the views of the author(s), and its conclusions may vary from those held elsewhere within Lazard Asset Management. Lazard is committed to giving our investment professionals the autonomy to develop their own investment views, which are informed by a robust exchange of ideas throughout the firm.

Notes

1 "Corporate Control Across the World"
2 The increased ownership concentration is also highlighted in a report from MSCI, with controlled companies accounting for nearly 46% of all constituents of the MSCI ACWI Index by count, as of 1 Feb 2022, a considerable increase from the 32% it reported in 2015 - Ownership and Control 2022: Global Equities Concentration on the Rise - MSCI
3 Source: OECD, 'Owners of the World's Listed Companies', October 2019
4 OECD Corporate Governance Factbook - OECD - 2023
5 Snap Inc. made history in 2017 by being the first company to issue only non-voting shares in its IPO.
6 Italy introduced loyalty shares in 2015, whereby listed companies were allowed to introduce a share structure where those who had held shares in a business for more than two years would get an extra voting right per share. This followed the example of France, which for a long time has allowed companies to opt in on the use of loyalty shares. France took another step in 2014 through the Loi Florange and changed the default voting system form "one share, one vote" into the loyalty system (making it an opt-out share structure). More recently, Spain introduced a loyalty shares system in 2021.
7 FCA confirms new Listing Rules to boost growth and innovation on UK stock markets
8 The proposed EU Directive on multiple-vote shares for SME listings, under discussion in the European Parliament, aims to encourage companies to list by allowing multiple voting share structures while safeguarding the interests of the company and of other shareholders - Multiple vote share structures: Council and Parliament adopt provisional agreement to ease SME's access to finance – February 2024 - pdf (europa.eu).
9 Global Governance Principles (lazardassetmanagement.com)
10 The Life-Cycle of Dual Class Firm Valuation – Martijn Cremers, Beni Lauterbach, and Anete Pajuste.
11 ICGN Governance Recommendations for the United States
12 H.R.2795 - 118th Congress (2023-2024): Enhancing Multi-Class Share Disclosures Act
13 Court of Chancery of the State of Delaware - Post-Trial Opinion on Richard J.Tornetta v. Elon Musk et al.

Important Information