DUAL-CLASS SHARE STRUCTURES IN SINGAPORE: LISTING FRAMEWORK AND FOUNDER AND INVESTOR CONSIDERATIONS

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INTRODUCTION

Since 26 June 2018, companies with a dual-class share (DCS) structure (DCS Co/s) have been able to apply to become listed on the mainboard of the Singapore Exchange (SGX). This form of public fundraising was previously only available to companies with a single class share (SCS) structure (SCS Co/s).

Prior to the introduction of DCS Co listings on the SGX, both private companies and non-listed public companies (with some minor exceptions) were already permitted under Singapore company law to establish and maintain share structures comprised of a combination of voting and non-voting shares (i.e., via the issuance of ordinary and preference shares). In this regard, while DCS structures are not a novel concept in Singapore, the move to allow a DCS Co to raise capital through an initial public offering (IPO) on the SGX is a new initiative that has implications for both the founders and investors of such companies.

As "new economy" companies particularly favour DCS structures, Singapore's suitability as a listing venue for such high-growth technology and innovation-focussed companies has also been enhanced.

DIFFERENCE BETWEEN A DCS CO AND SCS CO

A SCS Co operates on a one-share, one-vote basis.

A DCS Co, in contrast to a SCS Co, will generally have at least two classes of shares – one class which entitles the holder to one vote per share (usually offered to members of the public) and another class which entitles the holder to multiple votes (MV) per share (usually held by founders and other senior management within the company). As a result, MV class shareholders achieve outsized voting rights relative to their equity ownership in the company which, in practice, allows for the retention of control over decision making despite owning a modest stake in the company.

By way of example, due to its DCS structure, the *Ford Motor Company's* founding family shareholders are able to control 40% of the voting rights whilst holding only 4% of the total share capital of the company

BECOMING A SGX LISTED DCS CO

Eligibility

Importantly, only **new** issuers which are seeking a **primary** listing on the SGX mainboard can take advantage of the DCS listing framework. The other DCS listing requirements are twofold:

First, the applicant must first be able to satisfy the SGX's existing main board entry criteria (as set out in the SGX listing rules).

Second, the applicant must be deemed 'suitable' to uphold a DCS structure on the SGX. The SGX regulators' power in this regard is entirely discretionary. However, generally the following factors are considered when assessing suitability:

- Rationale for wanting the DCS structure (e.g., to accommodate innovation and high growth)
- Type of business model (e.g., if it has a conceptualised long-term plan that contemplates speeding up growth at a fast pace)
- Operating track record (e.g., trading history, regulatory compliance and corporate governance)
- Character and integrity of the management and controlling shareholders
- Role and involvement of the prospective MV shareholders in the business and their anticipated contribution to its success
- Level of sophisticated investor participation
- Any other features of the business considered pertinent to the maintenance of a DCS structure

Continuing Obligations

Once approved to list on the SGX, as well as complying with the ordinary SGX listing rules, a listed DCS Co must also adhere to the following requirements:

- Only one class of MV shares may be issued and the voting rights of the MV shares must be clearly stated in the constitution documents and limited to ten (10) votes per share
- MV shares must only be held by appointed directors or a 'permitted holder group' (PHG) (which must be represented by a responsible director with fiduciary duties) and the scope of the PHG must be identified at IPO
- Unless approved otherwise at a general meeting of independent shareholders on the basis of the customary one vote per share principle (Enhanced Voting Process), MV shares must automatically convert into ordinary one-vote shares if a MV shareholder:
  - Sells or transfers their MV shares to any person (other than to persons within the PHG)
  - Ceases to be a director, whether due to death, incapacity, retirement, resignation or otherwise (other than where a new director or responsible director being a MV shareholder is appointed)
- MV shareholders must not transfer or otherwise dispose of their MV shares within the 12-month period following the IPO
- Additional MV shares must not be issued post IPO (other than pursuant to events that would not increase the proportion of MV shares such as a rights or bonus issue, dividend reinvestment schedule or a share consolidation or subdivision)
- The Enhanced Voting Process (i.e., one for one) must be applied in respect of the following matters:
  - Making changes to the constitution
  - Varying the rights for a class of shares
  - Appointing and removing independent directors and/or auditors
  - Undertaking a reverse takeover, liquidation or delisting
- One-vote shareholders (not holding any MV shares) must have the power to:
  - Cast at least 10% of the total voting rights in a general meeting
  - Requisition a general meeting provided they hold at least 10% of the voting rights
- The majority of the audit, nominating and remuneration committees, and each of their respective appointed chairmen must be independent

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The above referred to requirements are also known as 'safeguards' because they are specifically designed to protect against the risks commonly associated with DCS structures, including entrenchment and corporate misconduct.

CONSIDERATIONS FOR FOUNDERS AND INVESTORS

"The advantage of a dual-class share structure is that it protects entrepreneurial management from demands of ordinary shareholders. The disadvantage of a dual class share structure is that it protects entrepreneurial management from demands of ordinary shareholders." Andrew Hill, *Financial Times*[1]

Such is the polarising nature of a DCS structure that its main benefits, in many cases, are also its biggest drawbacks depending on whether you are a founder or an investor. Below is a brief overview and analysis of some of the key issues that founders and investors should respectively consider in relation to adopting or investing in DCS structures.

Financing and Investment Opportunities

In the absence of any DSC listing option, companies led by founders with a strong desire to maintain control of the business that they helped to build (think start-ups, technology firms and private family firms) have generally been reluctant to raise funds through an IPO on the basis that they would lose all control once their preference shares automatically converted into ordinary shares, giving them 1:1 voting rights. The outcome of this has been not only to limit the financing options available to many high-growth, technology and innovation-focussed companies, but also to deprive potential investors of the opportunity to earn significant returns from investing in such companies if they were publicly listed on the SGX.

The establishment of the DCS listing framework in Singapore therefore broadens the range of public fundraising and investment options for founders and investors alike. For founders, it allows them access to capital markets for funding to scale their businesses while still maintaining control over their business. For investors, it will attract the listing of more new economy companies to Singapore's capital markets thereby giving investors greater diversity and choice as well as financial gains when considering that some of the largest companies in the world, based on market capitalisation, such as *Facebook*, *Alphabet*, and *Alibaba*, have all adopted a DCS structure.

Executive Control

As mentioned already, the single most overarching and radical feature of a DCS structure is that it allows founders (and/or other top executives) holding MV shares to control boardroom decisions, even as the economic interest in the company is more widely dispersed (i.e., among new and existing shareholders).

This arrangement is particularly attractive to founders, as well as investors of companies with an expected high growth trajectory (such as those in the technology and innovation sector) as it enables visionary leaders and entrepreneurs to tap into capital markets and execute their vision for the company without needing to be overly concerned about market performance and shareholder backlash in the early stages of being a publicly listed company. The underlying assumption of this argument is that the

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founders know what is best for their company, especially in its earlier years, and are willing to prioritise long term goals over immediate or short term gains.

A real-life example of the success of this argument is *Facebook* founder, Mark Zuckerberg's acquisition of *Instagram*. With 57% of the voting control rights in *Facebook*, Zuckerberg was able to effect the necessary corporate approvals, (with little or no board or shareholder consultation) to acquire *Instagram* for USD 1 billion in 2012. Today, *Instagram* is valued at approximately USD 54 billion (nine years after it was acquired), thereby vindicating Zuckerberg's decision with respect to the such an investment.

Equally, a company that has and maintains a small minority of controlling shareholders can also result in detrimental outcomes for the company and the rest of its shareholders who hold fewer voting rights but who have contributed most of the company's capital. In particular, it is theorised that DCS structures help to facilitate management entrenchment, that is, when it becomes almost impossible to remove certain members of management because they hold a substantial amount of the voting power. This allows for a scenario in which entrenched founders and executives can engage in poor decision making (e.g., pushing ahead with a failing business plan or pursuing transactions that only benefit the controlling shareholders), with little to no consequences for their actions.

The recent failed IPOs of *WeWork*, *Uber* and *Deliveroo* are said to have been directly or indirectly attributed to their DCS structures. In the case of *WeWork*, its CEO, Adam Neumann was given an extraordinary voting entitlement (20:1) which effectively enabled him to go rogue and was one of the main reasons for the major downfall of the company's valuation and ultimate withdrawal from its first IPO attempt. Similarly, *Uber's* CEO, Travis Kalanick used his superior voting rights to make decisions that were unprofessional and not in the best interests of the company or its majority investors. *Uber* has since converted its share structure and listed publicly as a SCS Co. Concerns around the lack of adequate protection for the minority shareholders of *Deliveroo* was also highlighted as being a key reason for its poor IPO performance.

Corporate Integrity and Reputation

While the adoption of DCS structures has steadily increased over time, so too has the amount of opposition against the use of DCS structures, largely on the basis that they provide a breeding ground for poor corporate governance practices.

The positive correlation between equal shareholder voting rights and board accountability is well-documented. For this reason, a SCS Co has historically been regarded as the optimal corporate structure because it promotes equality of ownership and alignment among shareholders which, in turn, tends to impact positively on the reputation and long-term success of a company.

Proponents of the traditional "one-share, one-vote" principle, which include many well-known economic and finance experts and influential institutional investors, also hypothesise that any contrary structure which purports to decouple voting rights from economic ownership, such as a DCS structure invariably leads to corporate governance issues (e.g., breach of fiduciary duties) and other negative outcomes for the company.

From the founder's perspective, the perpetuated stigma brought about by the rising number of adversaries of the DCS structure means that, even if a DCS Co has adequate corporate governance rules in place, potential investors may still hold the belief that the DCS structure somehow makes it a less reputable or less safe investment option.

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From the investor's perspective, public misconceptions aside, the potential risk of corporate abuse is still a very real one. As discussed already, holders of MV shares may entrench their control of the company thereby making themselves less accountable to other shareholders and able to preserve the current state of affairs, no matter how unsatisfactory it may be. The risk of corporate governance problems may be higher or lower for a DCS Co depending on the scope and nature of any corporate safeguards to begin with and the effectiveness of the board to oversee the company's affairs. As mentioned, there have been numerous examples of founders and executives abusing their outsized voting power for personal gain at the expense of the company's majority shareholders. Further, it is widely believed that DCS structures also increase agency costs for the company (i.e., due to there being a higher risk of conflicts of interest between shareholders and management) which are typically accompanied by lower company market valuations.

Suitability and Preference

The ultimate consideration for both founders and investors should always be their individual circumstances.

Founders need to have regard to the company's business model, needs and plans for growth, and whether these are congruent with the regulatory requirements for listing with a DCS structure and conducive to becoming a high-performing listed DCS Co, in each case, as compared with a SCS Co. On the one hand, it has been suggested that DCS structures are more appropriate for companies with rapid growth and potentially fluctuating revenues. However, companies with the same features have been found to have better long-term performance despite being listed as a SCS Co. Similarly, some findings indicate that a DCS Co, as compared with a SCS Co, produces lower share trading prices and overall lower returns to its investors. Other findings have indicated the opposite for companies in certain scenarios, including those having an aggressive growth model.

Investors also need to make their own judgement call to determine if the premiums or discounts outweigh the risks that come with investing in a DCS Co. One of the main arguments in favour of DCS structures is increasing investor sophistication and discretion. In other words, if investors are well-informed and are still averse to the idea of a DCS Co, they do not have to invest in it. For this reason, investors should not just rely on the safeguards to protect their interests in a DCS Co. Rather, investors should take the time to understand exactly how their rights will be affected and whether they are prepared to take on the risks involved. Some of the key areas that investors should focus on when considering whether to invest in a DCS Co include:

- The nature of the company's business and whether it is operating in a high growth area
- The company's track record
- Investor alignment with the founder's vision for the company
- The board composition in terms of skills, experience, diversity and independence
- The incentives (if any) being offered in exchange for having inferior voting rights

GLOBAL COMPARISON

With the amount of ongoing debate surrounding DCS Co listings, it is unsurprising the number of different approaches taken by countries. Several jurisdictions continue to maintain a blanket prohibition, some stock exchanges allow it subject to varying restrictions and requirements, and others are still considering the possibilities.

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In places such as **Australia** and the **United Kingdom**, SCS Co listings firmly remain the default position. In the former case, companies listed on the Australian Stock Exchange are prevented from issuing classes of shares with different voting rights, ruling out the option of DCS structures altogether. In the case of the latter, a DCS Co can only seek a listing on the London Stock Exchange Official List which does not permit entry into the main Financial Times Stock Exchange indices and is therefore less appealing to investors and founder-owners alike.

Hong Kong, like Singapore, recently introduced its own DCS structure listing framework, albeit with different eligibility and compliance requirements. By comparison, the Hong Kong regime is more focused on attracting innovative companies, and therefore uses a strict selection criterion which requires, among other things, the applicant company to satisfy minimum market capitalisation and revenue requirements and have a track record of high business growth.

DCS Co listings are most prominent in the **USA** and **Canada** which both allow for companies with DCS structures to be listed on their respective stock exchange mainboards. In particular, the USA is said to currently account for half of the companies listed with a DCS structure in the world. High profile examples of USA listed DCS Cos include *Facebook*, *Google*, and *LinkedIn*. In contrast to Singapore, both USA and Canada DCS Co listing requirements include the imposition of mandatory time limits and sunset provisions which call for MV share special voting rights to cease or be reviewed at the end of certain periods or on the occurrence of certain events.

CONCLUSION

It is ultimately the stock exchanges, along with regulators, that can determine the rules of the game in relation to an initial public offering or other type of listing. Some exchanges that previously forbade multiple-class shares are rethinking their position, as competition to court high-growth technology companies to list on their exchange intensifies.

It is always important to analyse the costs and benefits of DCS structure in a particular jurisdiction, and the ultimate analysis is whether it is possible to do a balancing act of finding ways to reap the benefits whilst mitigating the costs in the local context. The introduction of relevant safety mechanisms, including requirements as to entry, disclosure standards and safeguards to be adopted would also help in managing the risks of expropriation and entrenchment, while enabling the benefits of allowing the company to focus on long-term performance and enhancing competitiveness.