MULTIPLE SHARE CLASSES

POSITION PAPER

NORGES BANK INVESTMENT MANAGEMENT POSITION

1. Shareholders have a residual claim on the company's income and bear the ultimate economic risk. To protect their investment, all shareholders should have the right to vote on fundamental decisions concerning the company.

2. Voting rights should be proportionate to cash flow rights so that shareholders have the appropriate incentives when influencing the company. One share should give one vote.

3. Any unequal voting rights should be aligned with cash flow rights over time. Unequal voting rights should have a sunset clause, restricting the transfer of such shares or limiting the structure to a defined period.

BACKGROUND

Multiple class share structures provide investors in one share class with superior voting rights, out of proportion to the economic risk they are taking. These structures are most common with founders taking their company public, allowing them to maintain control while raising equity capital. This position paper considers the effect of multiple classes of common shares on effective governance and the protection of investors' rights.

The divergence of voting from cash flow rights can exacerbate agency problems and may entrench management. Research has shown that over a company's life cycle the costs related to agency problems tend to increase while the benefits decrease. At the same time, superior voting rights can help founders implement their long-term vision, shielded from short-term market pressures. Companies with dual class structures tend to exhibit a valuation premium at the time of listing and are associated with higher R&D expenditures.

In most cases, multiple share class structures eventually outlast the initial benefits offered by the personal involvement of a founder. Absent any self-correcting mechanism, superior voting rights are transferred to other investors, and the structure is perpetuated.

As a global investor, we observe that multiple voting rights are allowed in almost half of the markets and explicitly prohibited in just a third of the markets surveyed by the OECD. Recently, the stock exchanges of Hong Kong and Singapore began accepting new initial public offerings with dual share structures. With fewer companies going public, granting more voting rights to founders is considered one way to make initial public offerings more attractive.

ARGUMENTS FOR THE POSITION

Shareholder voting rights compensate for higher economic risk

As residual claimants, shareholders bear the ultimate economic risk. Aligning voting power with economic risk maximises incentives for all shareholders to hold the board to account, to make informed voting decisions, and otherwise to maximise the company's return.

Unequal voting rights can harm minority shareholders

Shareholders with superior voting rights, particularly when they are insiders, may have incentives and opportunities to influence corporate actions in ways that may maximise their private benefits rather than company value at the expense of minority shareholders.

A sunset clause aligns voting with cash flow rights

A sunset clause limits the negative effects of unequal voting rights by automatically converting shares to one class when they are transferred, when the founder leaves an executive position, or after a set period. It gives shareholders certainty that multiple share classes will be abolished when circumstances change.

ARGUMENTS AGAINST THE POSITION

Unequal voting rights encourage companies to go public

Giving more voting rights to founders allows them to raise capital in public markets from a wide range of investors while maintaining control. This can motivate founders to list at the growth stage when they view control over the company as essential to implement their vision.

Founders have superior knowledge of the company

Founders often have deep knowledge of the business and make long-term, company-specific investments. Superior voting rights allow insiders to implement their long-term plan, while protecting them from exposure to the short-term pressures of financial markets and uninformed shareholders.

A sunset clause makes listing unattractive

The benefits of a founder’s superior skills do not expire at a set date after listing. Time-based sunset clauses may collapse voting rights pre-maturely, disincentivise management and thereby reduce company value. Restricting founders from transferring their shares further disincentivises companies from going public.

NORGES BANK INVESTMENT MANAGEMENT’S CONSIDERATION

Weighing the arguments, we believe that shareholders as bearers of the ultimate economic risk should be compensated through the right to vote on major corporate decisions. While multiple share classes may in some cases be efficient at the time of listing, voting rights should be aligned with cash flow rights over time.

We believe that the “one share, one vote” principle is the best regime to secure the fair treatment of all shareholders and hold the board of directors to account. Founders may have superior knowledge, and greater control rights can support them in implementing their vision. However, we are concerned about the effect of unequal voting rights on minority shareholders. Unequal voting rights may entrench management and put minority shareholders at increased risk of value-reducing actions.

We observe an increasing number of companies going public with unequal share class structures to maintain a founder’s control. We are supportive of measures that motivate companies to go public and understand that unequal voting rights may encourage founders to list early. However, companies’ requirements change over time, and founders’ skills are not easily transferrable. Where a company chooses unequal voting rights, this structure should be tied to the founder’s equity ownership or be limited in time.

This position will serve as a basis for our discussion with boards.