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Google, Facebook and Snap challenge governance standards

Tech groups dual class structures threaten principle of 'one share, one vote'

Warren Buffet, Berkshire Hathaway; Jack Ma, Alibaba; Evan Spiegel, Snap; Mark Zuckerberg, Facebook

Attracta Mooney and **Robin Wigglesworth** MAY 27 2018

Snap, the disappearing messaging app, caused uproar among investors last year after it sold $3.4bn of stock with no voting rights during its initial public offering.

It was the latest sign for many investors that the long-held principle of "one share, one vote" was being eroded by companies, which readily accept fund managers and pension funds' money but were, the investors believed, increasingly unwilling to give them sufficient say on how those businesses were run.

In the months since, a growing number of investors have stepped up their lobbying efforts against what they see as the watering down of governance standards globally, warning that shareholders need to be able to hold companies to account.

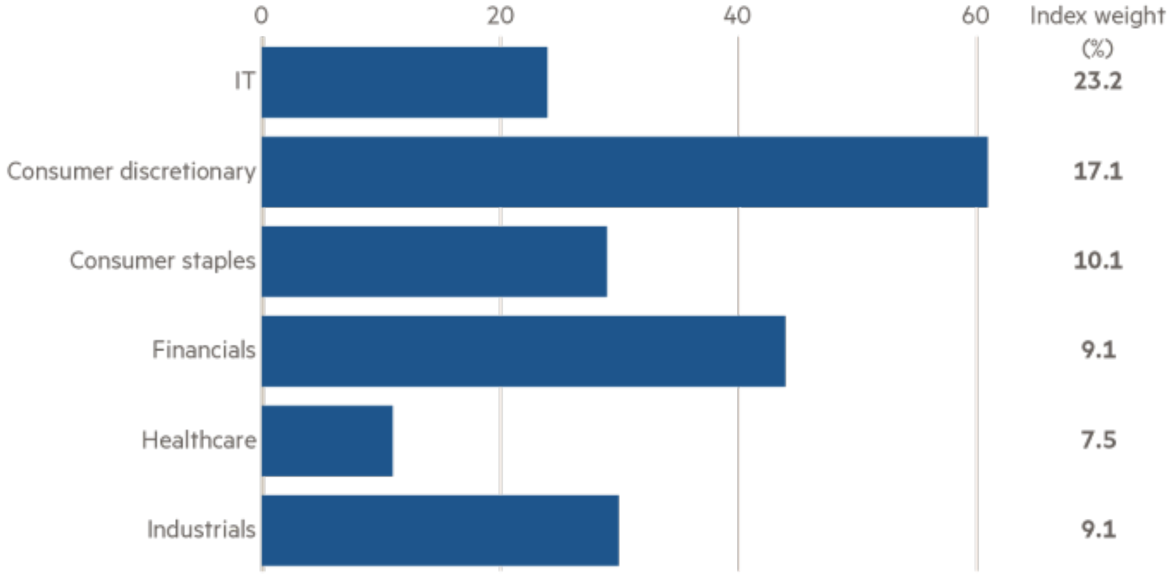
Deborah Gilshan, environmental, social and governance investment director at Standard Life Aberdeen, one of Europe's largest-listed fund houses, says: "One share, one vote is the bedrock of corporate governance. It has always been the case that you should have a vote for every share you own."

The focus on unequal voting rights comes as asset managers are under growing pressure to hold companies to account. Many pension funds and other clients are increasingly asking their fund managers to ensure companies behave responsibly.

Mary Leung, head of advocacy for Asia Pacific at the CFA Institute, the global body for investment professionals, says: "We are seeing increasing engagement between investors and companies and it would be sad to see that decline because investors have fewer rights."

Three decades ago, dual share classes were uncommon and typically found in family-controlled companies, such as South Korea's Samsung, which has non-voting preferred shares, Switzerland-based healthcare company Roche and Sweden's H&M, the retailer. But that changed when Google decided to list in 2004. Rather than follow the long-held practice of offering every shareholder a vote for each share they held, the technology group's initial public offering featured dual-class shares — giving some shareholders more say than others.

Unequal voting rights by sectors*



* MSCI World index as of Sept 2017
Source: MSCI
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As other west coast companies followed in the footsteps of Google, whose parent company later became known as Alphabet, and the valuation of technology groups grew rapidly, companies with dual-class shares began to account for a bigger proportion of indices, the benchmarks investors used to measure performance. Businesses with unequal voting rights accounted for just 4 per cent of the MSCI World Index by weight in 2004, but the figure now stands at 10 per cent.

Rob Dowling, a fund manager at Legal and General Investment Management, which oversees $1tn in assets, says there is growing concern among investors about this shift towards unequal voting rights. "When it was a smaller proportion of companies, it wasn't ideal but it wasn't a major concern. But as the proportion of companies [with unequal voting rights] has grown, it has become a bigger issue."

Ms Leung says the decision by Google, led by Sundar Pichai, and later Facebook, founded by Mark Zuckerberg, to list with unequal voting rights led to rapid changes in governance. "Because [Google and Facebook] were so successful a lot of companies want to emulate them. Rightly or wrongly, [some management] see having a dual share class structure as being part of that success," she says.

In a sign that big investors are losing their battle against dual-class share, Dropbox, the internet storage group, listed this year with unequal voting rights. Its B shares carry 10 votes for every class-A vote.

Entrepreneurs have argued that by keeping control of the company, they are able to make decisions for the long-term rather than react to the short-term whims of shareholders. But Ms Leung says that argument holds little sway with the CFA. While she acknowledges that, sometimes, it might make sense at the time of listing to have dual-class shares, she argues they should be phased out over time. "We believe one share, one vote is the golden principle."

The US, Sweden, Germany, South Korea and Brazil are all home to companies with two share classes. Now other countries are looking to follow suit.

Hong Kong changed its rules this year to allow companies to list with dual-class shares. The move came after it missed out on the listing of Alibaba, the Chinese ecommerce group led by Jack Ma, which opted for New York. Singapore is expected to make a decision about changing its rules in the next few weeks, while other exchanges are also understood to be considering revisiting the issue.

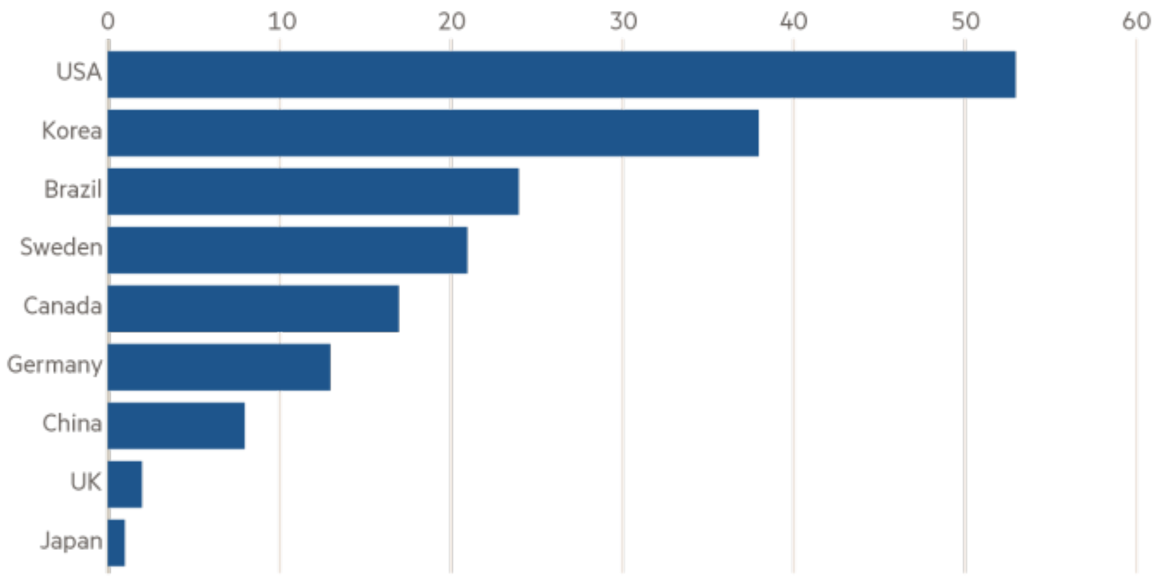
"With Hong Kong changing its rules and Singapore close to follow, it will kick-start a chain reaction. I don't know who will be next. For us, it is very worrying," says Ms Leung.

Andrew Ninian, director of stewardship and corporate governance at the Investment Association, the UK trade body, describes the trend of stock exchanges globally lowering listing standards to attract new companies as a "race to the bottom". He adds that it is "essential the UK continues to uphold these robust principles to protect investors".

Investors have already had some success with their lobbying over unequal voting rights. After Snap's move last year, the largest index providers — which are the benchmarks that fund managers are typically measured against — decided to exclude Snap from their indices. FTSE Russell also said it would exclude from its benchmarks stocks that did not give shareholders at least 5 per cent of the voting power, and is planning a further consultation this year.

S&P Dow Jones Indices no longer allows companies with multiple share classes to join various indices including the S&P 500, the index of large US companies. Existing constituents, such as Berkshire Hathaway and Facebook, can remain.

Country distribution of securities with unequal voting rights*



* MSCI World index as of Sept 2017
Source: MSCI
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In January, MSCI, the index provider, launched a consultation to examine how it should deal with other types of unequal voting structures. It has proposed that it will continue to include stocks with unequal voting rights in its indices but will adjust the weights of these stocks to reflect both their free floats and their company level listed voting power. MSCI is expected to make a decision next month.

Sacha Sadan, director of corporate governance at LGIM, says he backs the moves by index providers, arguing it is vital that all parts of the investment chain work to stop any watering down of governance standards.

Others have been less supportive. BlackRock, the world's biggest investor, said in April that index providers should leave corporate governance standard-setting to regulators rather than try to engineer improvements through benchmark exclusions.

Vanguard, the second-largest investor, says its underlying stance is in support of "one share, one vote". "However, when it comes to inclusion in an index, we believe companies with limited voting rights cannot be excluded from the indices at this time. If an index intends to be representative of the market, companies that meet these stated standards should be included and properly weighted to reflect their market cap."

Others argue that it is vital that companies are not incentivised to list with unequal voting rights. They point to Facebook, where the issue of unequal voting rights has left many shareholders with less say — something they argue could have influenced the recent scandals at the social media company.

Aeisha Mastagni, a portfolio manager, corporate governance, at Calstrs, the US pension fund, said this month that it was time for Facebook's voting structure to evolve. "It is time to end the dual class," she said.

Ms Gilshan adds: "If you are engaging with a company with unequal voting rights, your voice means less."