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Theory, Evidence, and Policy on Dual-Class Shares: A Country-Specific Response to a Global Debate

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Abstract

Dual-class shares have become one of the most controversial issues in today´s capital markets and corporate governance debates around the world. Namely, it is not clear whether companies should be allowed to go public with dual-class shares and, if so, which restrictions (if any) should be imposed. Three primary regulatory models have been adopted to deal with dual-class shares: (i) prohibitions, existing in countries like the United Kingdom, Germany, Spain, Colombia, or Argentina; (ii) the permissive model adopted in several jurisdictions, including Canada, Sweden, the Netherlands, and particularly the United States; and (iii) the restrictive approach recently implemented in Hong Kong and Singapore. This paper argues that, despite the global nature of this debate, regulators should be careful when analysing foreign studies and approaches, since the optimal regulatory model to deal with dual-class shares will depend on a variety of local factors. It will be argued that, in countries with sophisticated markets and regulators, strong legal protection to minority investors, and low private benefits of control, regulators should allow companies going public with dual-class shares with no restrictions or minor regulatory intervention (e.g., event-based sunset clauses). By contrast, in countries without sophisticated markets and regulators, high private benefits of control, and weak legal protection to minority investors, dual-class shares should be prohibited or subject to higher restrictions (e.g., time-based sunset clauses and stringent corporate governance rules). Intermediate solutions should be adopted for countries with mixed features. After analysing the theoretical and empirical literature on dual-class shares, as well as the different regulatory approaches adopted across jurisdictions, this article concludes that there are no single answers and regulatory models to deal with dual-class shares. The 'right' regulatory approach will depend on a variety of local factors. For this reason, the key question to be addressed from a policy perspective is not whether companies should be allowed to go public with dual-class shares but whether they should be allowed and, if so, under which conditions, taking into account the particular features of a country.

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1. Introduction

Dual-class shares have become one of the most controversial issues in corporate governance and capital markets around the world.[2] On the one hand, a tough regulatory competition to attract IPOS has led many stock exchanges, including the Singapore Exchange (SGX) and the Stock Exchange of Hong Kong (HKEX), to revise their regulatory framework to allow companies going public with dual-class shares provided that several requirements are met. On the other hand, Nasdaq and the New York Stock Exchange (NYSE) in the United States have been asked by the Council of Institutional Investors to impose time-based sunset clauses to firms going public with dual-class share structures.[3] In the meantime, other leading financial centres, including London and Frankfurt, still prohibit companies from going public with dual-class shares, even though it remains to be seen whether they will keep this approach –especially in the case of the United Kingdom after Brexit– in the light of the competitive regulatory environment existing in today´s capital markets.

This paper argues that, despite the global nature of this debate, the desirability of dual-class shares differs across jurisdictions. Therefore, regulators should be careful when they assess foreign studies and regulatory models, since the 'optimal' regulatory approach will depend on a variety of local factors. Hence, the question is not whether companies should be allowed to go public with dual-class shares but whether they should do so, and if so how, *taking into account* the particular features of a country.

Section 2 discusses the features and rationale of dual-class share structures and the misconceptions surrounding the 'one share one vote' principle traditionally existing in corporate law. While this article will be focused on the use of dual-class shares by companies going public, it should be kept in mind that companies might decide to create dual-class share structures at different stages: (i) when they are privately held firms; (i) when they decide to go public; and (iii) when they are already listed companies. In general, most countries around the world allow private companies to have shares with multiple voting rights due to the reduced contracting failures existing in these companies.[4] In public companies, however, that is not the case: due to the greater separation of ownership and control, insiders can use their power and superior information to take advantage of public investors. [5] Moreover, before going public, the

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[2] John C Coffee Jr., *Dual Class Stock: The Shades of Sunset,* THE CLS BLUE SKY BLOG, November 19, 2018 (available at http://clsbluesky.law.columbia.edu/2018/11/19/dual-class-stock-the-shades-of-sunset/).

[3] The Council of Institutional Investors has submitted a proposal to Nasdaq and the New York Stock Exchange to impose a 7 year mandatory sunset clause. After this period, the dual-class shares will disappear unless a majority of minority investors decides otherwise. For the analysis of this proposal, see Council of Institutional Investors, *Investors Petition NYSE, NASDAQ To Curb Listings of IPO Dual-Class Share Companies,* 24 October 2018 (available at https://www.cii.org/files/issues_and_advocacy/correspondence/FINAL%20Dual%20Class%20Petition%20Press%20Release%20Oct%2024,%202018.pdf).

[4] Privately held corporations are exposed to lower negative externalities. Likewise, investors do not face the severe asymmetries of information and lack of bargaining power existing in a large listed company. Therefore, it makes more sense to provide greater flexibility and contractual freedom to privately held companies. For an overview of this discussion, see the papers in the symposium edition entitled *Contractual Freedom and Corporate Law*, 89 COLUMBIA LAW REVIEW 1395 (1989); Marco Ventoruzzo, *Regulatory Competition and Freedom of Contract in U.S. Corporate Law*, STATE LAW RESEARCH PAPER NO. 11 (2016) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2776945); John Armour, Henry Hansmann, Reinier Krakmaan, and Mariana Pargendler, *The Basic Governance Structure: The Interests of Shareholders as a Class*", in John Armour, Luca Enriques *et al*, THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH (Oxford University Press, 2017), pp. 18.

[5] Jeffrey N. Gordon, *Ties that Bind: Dual Class Common Stock and the Problem of Shareholder Choice*, 76(1) CALIFORNIA LAW REVIEW 1 (1988); Ronald J. Gilson, *Evaluating Dual Class Common Stock: The Relevance of Substitutes*, 73 VIRGINIA LAW REVIEW 807 (1987); Daniel R. Fishel, *Organised Exchanges and the Regulation of Dual Class Common Stock*, 54 UNIVERSITY OF CHICAGO LAW REVIEW 119 (1987); Guido

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founders have incentives to choose an optimal governance structure to go public in order to succeed in the IPO. However, if the company is already public, a sudden change in the governance or share structure may not have the same impact. Therefore, insiders may have more incentives to opportunistically change the share structure. For this reason, most countries around the world prohibit dual-class recapitalization.[6]

Section 3 explains the rise of the debate on dual-class shares in recent years. Section 4 discusses the arguments in favour and against dual-class share structures. Section 5 reviews the empirical literature on dual-class shares. Section 6 analyses the different regulatory approaches to deal with dual-class shares. Section 7 explains why several factors existing in a particular country may affect the desirability of, and therefore the regulatory model to deal with, dual-class shares. Section 8 advocates for a country-specific solution to the phenomenon of dual-class shares. Section 9 concludes.

2. Features and rationale of dual-class shares and the misconception surrounding the 'one share one vote' principle in corporate law

In a dual-class shares structure, the company´s common equity is divided into different classes of shares: (i) one class of shares ("Class B" shares), usually kept by the founders and its executives, entitle their holders to multiple voting rights per share; (ii) another class of shares ("Class A shares"), usually sold to public investors, embraces the one share one vote principle.[7] Thus, the use of dual-class shares allows founders to keep control with a minority of the company´s share capital.[8]

As it has been mentioned, a company may decide to create dual-class share structures at different stages. This article will focus on whether firms should be allowed to go public with dual-class shares structure, since it is in this context where most countries around the world differ, finding the United Kingdom, Germany, Spain, or Colombia on one side of the scene (prohibiting the use of dual-class shares), Sweden, Canada, Netherlands and the United States on the other (allowing companies going public with dual-class shares), and Hong Kong and Singapore in the middle (imposing several restrictions for companies seeking to go public with dual-class shares).

Ferrarini, *One Share - One Vote: A European Rule?*, ECGI LAW WORKING PAPER NO. 58 (2006) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=875620&rec=1&srcabs=976159&alg=1&pos=6).

[6] This prohibition even exists in countries generally friendly with the use of dual-class shares such as the United States. However, this prohibition has not always existed. For an analysis of the prohibition of dual-class recapitalisations in the United States and the rationale behind it, Jeffrey N. Gordon, *Ties that Bind: Dual Class Common Stock and the Problem of Shareholder Choice*, 76(1) CALIFORNIA LAW REVIEW 1 (1988) (available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=1906&context=californialawreview); Stephen M. Bainbridge, *Revisiting the One Share/ One Vote Controversy: The Exchanges' Uniform Voting Rights Policy*, 22 SECURITIES REGULATION LAW JOURNAL 175, 176 (1994).

[7] For the concept of dual-class shares, see Lucian A. Bebchuk, Reinier Kraakman and George Triantis, *Stock Pyramids, Cross-Ownership and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights*, CONCENTRATED CORPORATE OWNERSHIP (R. Morck, ed.) pp 445-460 (2000); Lucian A. Bebchuk and Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class* Stock, 103 VIRGINIA LAW REVIEW 685 (2017); For a comparative, and comprehensive analysis of dual-class shares, see Hong Kong Stock Exchange, *Concept Paper: Weighted Voting Rights* (August 2014), (available at https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2011-to-2015/August-2014-Weighted-Voting-Rights/Consultation-paper/cp2014082.pdf), and CFA Institute, *Dual-class Shares: The Good, the Bad, and the Ugly, A Review of the Debate Surrounding Dual-Class Shares and Their Emergence in Asia Pacific* (2018) (available at https://www.cfainstitute.org/-/media/documents/survey/apac-dual-class-shares-survey-report.ashx).

[8] Lucian A. Bebchuk and Kobi Kastiel, *The Perils of Small-Minority* Controllers, ECGI LAW WORKING PAPER NO. 434 (2018) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3128375).

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Despite the rise of the debate in recent years, dual-class share structures are not a new phenomenon. Deviations from the one share, one vote rule are as old as the corporate form.[9] Moreover, while the common perception is that the one share, one vote rule has been one of the most important principles of corporate law[10], this is a misconception.[11] While this principle has been adopted 'on the books' by most jurisdictions around the world, sometimes the one share one vote principle is the *exception* rather than the rule in practice. First, some companies deviate from the one share one vote by issuing *preference shares* – that is, shares with no voting rights in exchange for additional economic advantages attached to those shares.[12] In fact, these shares might be common in certain countries with underdeveloped capital markets and many retail, rationally apathetic investors.[13] Through the issuance of preference shares, controllers may raise capital without losing control. Therefore, preference shares, as dual-class shares, serve as a mechanism to separate cash-flow rights from voting rights,[14] potentially creating controlling minority shareholders.[15]

Second, other companies or legislations impose caps on voting rights, as well as majority of minority approvals for certain transactions.[16] Therefore, while the cash-flow rights of controlling shareholders remain unaffected, these minority approvals or limitations of voting rights sometimes make the company deviate, in practice, from the one share, one vote principle.

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[9] See Stephen M. Bainbridge, *Understanding Dual Class Stock Part I: An Historical Perspective*, 9 September 2017 (available at https://www.professorbainbridge.com/professorbainbridgecom/2017/09/understanding-dual-class-stock-part-i-an-historical-perspective.html).

[10] The 'one share one vote' principle has been seen as a cornerstone of corporate law. According to this principle, each shareholder´s voting rights will be based on the number of shares owned by the shareholder. For an analysis of this principle, see Guido Ferrarini, *One Share - One Vote: A European Rule?*, ECGI LAW WORKING PAPER NO. 58 (2006) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=875620&rec=1&srcabs=976159&alg=1&pos=6); Luca Enriques, Henry Hansmann, Reinier Kraakman and Mariana Pargendler, *The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies*, in John Armour, Luca Enriques *et al*, THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH (Oxford University Press, 2017), pp. 80-83; Sanford J. Grossman and Oliver D. Hart, *One Share One Vote and the Market for Corporate Control*, NBER WORKING PAPER NO. 2347 (1987) (available at https://www.nber.org/papers/w2347).

[11] See Stephen M. Bainbridge, *Understanding Dual Class Stock Part I: An Historical Perspective*, 9 September 2017 (available at https://www.professorbainbridge.com/professorbainbridgecom/2017/09/understanding-dual-class-stock-part-i-an-historical-perspective.html). According to Bainbridge: *"(…) Prior to the adoption of general incorporation statutes in the mid-1800s, the best evidence as to corporate voting rights is found in individual corporate charters granted by legislatures. Three distinct systems were used. A few charters adopted a one share-one vote rule. Many charters went to the opposite extreme, providing for one vote per shareholder without regard to the number of shares owned. Most followed a middle path, limiting the voting rights of large shareholders. Some charters in the latter category simply imposed a maximum number of votes to which any individual shareholder was entitled. Others specified a complicated formula decreasing per share voting rights as the size of the investor's holdings increased. These charters also often imposed a cap on the number of votes any one shareholder could cast (…).*

[12] For an analysis of these shares, see Eilis Ferran and Look Chan Ho, PRINCIPLES OF CORPORATE FINANCE LAW (Oxford University Press, 2014), pp. 132-136.

[13] For example, the issuance of ordinary shares is not very common in countries like Brazil and Colombia, where retail investors still play a major role. Therefore, companies in these countries often issue preference shares instead.

[14] Unlike other forms of separation cash-flow rights from voting rights though, holders of preference shares are compensated for giving up their voting rights. This is accomplished through several mechanisms, including a mandatory dividend, a higher dividend, or a higher priority in the event of insolvency.

[15] For this concept, see Lucian A. Bebchuk, Reinier Kraakman and George Triantis, *Stock Pyramids, Cross-Ownership and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights*, THE CONCENTRATED CORPORATE OWNERSHIP (R. Morck, ed.), pp. 445-460 (2000);

[16] Jesse M. Fried, Ehud Kamar and Yishay Yafeh, *The Effect of Minority Veto Rights on Controller Tunnelling*, ECGI LAW WORKING PAPER NO. 385 (2018) (available at https://ecgi.global/sites/default/files/working_papers/documents/finalfriedkamaryafeh_0.pdf).

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Third, in many countries, it is also common to observe deviations from the one share, one vote through the use of stock pyramids and cross-ownership.[17] In a typical stock pyramid, founders obtain control through complex group structures with several layers.[18] In situations of cross-ownership, companies are linked by horizontal cross-holdings of shares that 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 the control of a corporation.[19] In both cases, a minority stake can lead to a majority of the company´s voting rights.

As a result of these situations, while many countries embrace the one share, one vote principle 'on the books', the reality is quite different. Therefore, regardless of being in favour or against deviations from the one share, one vote principle, there seems to be a misconception surrounding this principle, since it is *formally* considered a cornerstone of corporate law while its deviation is actually very common – and not only in the context of dual-class share structures.

3. The renaissance of dual-class share structures

While firms with dual-class share structure are not new, the use of dual-class shares have become particularly relevant in the past years a result of various events. First, there has been a significant increase in the number of companies going public with dual-class shares in the United States: from 46 dual-class firms going public between 2006-2010 to a total of 104 companies between 2011-2015.[20] Nowadays, public companies in the United States with dual-class shares are worth more than $5 trillion.[21]

Second, tough regulatory competition to attract IPOs has led many jurisdictions to reconsider their regulatory framework regarding dual-class shares structures.[22] This has been the case of two leading financial centres such as Hong Kong and Singapore.[23] Traditionally, companies in these jurisdictions were not allowed to go

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[17] Lucian A. Bebchuk, Reinier Kraakman and George Triantis, *Stock Pyramids, Cross-Ownership and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights*, THE CONCENTRATED CORPORATE OWNERSHIP (R. Morck, ed.), pp. 445-460 (2000); Rafael La Porta, Florencio López de Silanes and Robert Vishny, *Corporate Ownership Around the World*, 54 JOURNAL OF FINANCE 471 (1999); Stijin Claessens, Simeon Djankov and Larry H.P Lang, *The Separation of Ownership and Control in East Asian Corporations*, 58 JOURNAL OF FINANCIAL ECONOMICS 81 (2000); Ronald W Masulis, Peter Kien Pham and Jason Zein, *Family Business Groups Around the World: Financing Advantages, Control Motivations and Organizational Choices*, 24 THE REVIEW OF FINANCIAL STUDIES 3556 (2011).

[18] Lucian A. Bebchuk, Reinier Kraakman and George Triantis, *Stock Pyramids, Cross-Ownership and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights*, CONCENTRATED CORPORATE OWNERSHIP (R. Morck, ed.), pp. 445-460 (2000); Lucian A. Bebchuk and Kobi Kastiel, *The Perils of Small-Minority* Controllers, ECGI LAW WORKING PAPER NO. 434 (2018) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3128375).

[19] Guido Ferrarini, *Corporate Ownership and Control Law Reform and the Contestability of Corporate Control*, presented at the OECD CONFERENCE ON COMPANY LAW REFORM IN OECD COUNTRIES A COMPARATIVE OUTLOOK OF CURRENT TRENDS (2000), pp. 11 (available at https://www.oecd.org/corporate/ca/corporategovernanceprinciples/1931676.pdf).

[20] Jay Ritter, *Initial Public Offerings: Updated Statistics* (2018), available at https://site.warrington.ufl.edu/ritter/files/2018/07/IPOs2017Statistics_July11_2018.docx).

[21] Robert J. Jackson Jr, *Perpetual Dual-Class Stock: The Case Against Corporate Royalty*, U.S. SECURITIES AND EXCHANGE COMMISSION (2018) (available at https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty).

[22] For a comparison of the regulatory framework of dual-class shares in Hong Kong and Singapore, see CFA Institute, *Dual-class Shares: The Good, the Bad, and the Ugly, A Review of the Debate Surrounding Dual-Class Shares and Their Emergence in Asia Pacific* (2018), pp. 50-52 (available at https://www.cfainstitute. Org/-/media/documents/survey/apac-dual-class-shares-survey-report.ashx).

[23] The discussions leading to the implementation of dual-class shares in these jurisdictions seemed to start with the unsuccessful attempt of Alibaba to go public in Hong Kong. See CFA Institute, *Dual-class Shares: The Good, the Bad, and the Ugly, A Review of the Debate Surrounding Dual-Class Shares and Their*

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public with dual-class shares.[24] Since 2018, however, they are able to do so, provided that they meet certain requirements.[25]

Third, most tech companies that went public in the past years –including Google, Alibaba, Facebook, Linkedin and, more recently, Snapchat, Pinterest, and Lyft– did so with dual-class shares structures.[26] Therefore, dual-class shares not only can be seen as a powerful tool to promote IPOs but also to create and promote the financing and growth opportunities of the tech companies. As a result, dual-class shares can be more attractive for countries interested in leading the 4th Industrial Revolution.

4. The pros and cons of dual-class shares

4.1. The benefits associated with the use of dual-class shares

Several arguments seem to support the use of dual-class shares. First, by allowing companies going public with dual-class shares, entrepreneurs will not face the fear of losing control and therefore they will have more incentives to take their companies public.[27] Therefore, several benefits can be created. On the one hand, founders will have the opportunity to raise more funds – not only due to the money raised at the IPO but also afterwards.[28] Thus, they will be in a better position to expand their businesses, contributing to create jobs, innovation, and wealth. On the other hand, investors will enjoy the opportunity to easily invest in companies that may outperform the market.[29] Therefore, the profits of a successful business will be shared with a larger number of investors. Finally, by making it more attractive for founders to take their company public, securities regulators would also contribute to the development of their local capital markets, and this latter aspect can be desirable not only for investors and the market itself –since it may bring more trading, liquidity and informational efficiency– but

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Emergence in Asia Pacific (2018), pp. 2 (available at https://www.cfainstitute.org/-/media/documents/survey/apac-dual-class-shares-survey-report.ashx).

[24] In Hong Kong, dual-class shares were allowed in the past though. See (Robin) Hui Huang, *The (Re)introduction of Dual-Class Share Structures in Hong Kong: A Historical and Comparative Analysis* (2018) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3245885).

[25] For an analysis of these requirements, see note 19 above.

[26] See Palepu, Krishna, Suraj Srinivasan, Charles C Y. Wang and David Lane, *Alibaba Goes Public (B)*, HARVARD BUSINESS SCHOOL SUPPLEMENT 116-031 (2016); Lucian A. Bebchuk and Kobi Kastiel, *The Perils of Pinterest's Dual-Class Structure*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (2019) (available at https://corpgov.law.harvard.edu/2019/04/10/the-perils-of-pinterests-dual-class-structure/); Lucian A. Bebchuk and Kobi Kastiel, *The Perils of Lyft's Dual-Class Structure* HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (2019) (available at https://corpgov.law.harvard.edu/2019/04/03/the-perils-of-lyfts-dual-class-structure/).

[27] According to a survey to CFOs, losing control is one of the most important reasons to stay private. James C. Brau and Stanley E. Fawcett, *Initial Public Offerings: An Analysis of Theory and Practice*, 61 THE JOURNAL OF FINANCE 399 (2006).

[28] Since the company is already public, and therefore it will probably have better corporate governance practices in place (not only imposed by the regulator but also because the higher scrutiny by the market will encourage better practices), the company will be in a position to raise money at a lower cost. Analyzing the relationship between corporate governance and firm´s access to finance, see Rafael La Porta, Florencio Lopez de Silanes, Andrei Shleifer, and Robert W. Vishny, *Legal Determinants of External Finance*, 52 JOURNAL OF FINANCE 1131 (1997); Rafael La Porta, Florencio López de Silanes, Andrei Shleifer and Robert W. Vishny, *Investor protection and corporate governance*, 58 JOURNAL OF FINANCIAL ECONOMICS 3 (2000). Moreover, investors will probably face lower asymmetries of information. Therefore, good companies will be in a position to raise money in a world with lower asymmetries of information.

[29] See CFA Institute, *Dual-class Shares: The Good, the Bad, and the Ugly, A Review of the Debate Surrounding Dual-Class Shares and Their Emergence in Asia Pacific* (2018) at pp. 1(available at https://www.cfainstitute.org/-/media/documents/survey/apac-dual-class-shares-survey-report.ashx).

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also for a variety of stakeholders, including stock exchanges, lawyers, bankers, and accountants. Therefore, the attraction of IPOs can be an attractive goal for a country.[30]

Second, the use of dual class shares is a way to allow founders to create value by pursing their –sometimes unique– 'idiosyncratic vision'.[31] And as history has shown in cases like Steve Jobs or Mark Zuckerberg, letting founders pursue their vision can also be a profitable business for investors.[32]

Third, the use of dual-class shares may protect companies from shareholder activists.[33] Therefore, founders and directors can focus on their long-term projects, which can be desirable to promote innovation, R&D, sustainable employment and growth.[34]

Fourth, while dual-class recapitalizations are prohibited in most countries around the world due to the higher risk of opportunism by insiders, companies going public with dual-class shares provide a fair and transparent deal: investors have the opportunity to invest or not in a company, instead of being subject to an unwanted share structures, as it could happen with a dual-class recapitalization. If investors do not trust the founders, or they think they might lose faith in them after a period of time, they will not buy the shares or they will do so at a discount. Therefore, they are not forced to buy the shares. If they do so, it is probably because they think it will be a profitable investment. Hence, in the absence of fraud or any type of opportunistic behaviour, there should be no reasons to complain if the investment does not turn out as expected. It is part of the game in securities markets. Besides, while investors can be protected *ex ante* by just deciding not to invest in a dual-class firm, they can also be protected *ex post* through exit rights: in the absence of a bad performance, they can just sell their shares.

Fifth, market forces mainly associated with higher valuation and firms´ ability to raise finance incentivize founders to choose efficient corporate governance structures at the IPO-stage.[35] As it has been mentioned, investors will discount (or they might not even

[30] Nonetheless, it should be kept in mind that regulators should not get obsessed with the development of capital markets. As some authors have argued, the key variable for the promotion of economic growth is financial development, regardless of how it is achieved: through the capital markets or the banking system. See Asli Demirguc-Kunt and Ross Levine, *Bank-based and Market-based Financial Systems: Cross-country Comparisons*, THE WORLD BANK- POLICY RESEARCH WORKING PAPER NO. WPS 2143 (1999) (available at http://documents.worldbank.org/curated/en/259341468739463577/Bank-based-and-market-based-financial-systems-cross-country-comparisons). However, it will be difficult to promote financial developments and the goals of the financial system in the absence of competition among providers of financial services. For the goals of the financial system, see John Armour et al, PRINCIPLES OF FINANCIAL REGULATION (Oxford University Press, 2016), pp. 22-50; See also Ross Levine, *Financial Development and Economic Growth: Views and Agenda*, 35(2) JOURNAL OF ECONOMIC LITERATURE 688 (1997).
[31] Zohar Goshen and Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE LAW JOURNAL 560-795 (2015).
[32] When it went public in 2004, Google's shares were priced at $85 per share. This increased to about $600 in 2007, and about $1,103 in 2019. Similarly, a $1,000 investment in Facebook at the time of its IPO in 2012 would have increased to about $4,600 in 2018. See Peter Edmonston, *Google's IPO Five Years Later*, THE NEW YORK TIMES (19 August 2009) (available at https://dealbook.nytimes.com/2009/08/19/googles-ipo-5-years-later/); Yahoo Finance, *Google Nasdaq Real Time Price* (available at https://finance.yahoo.com/quote/GOOG/history/). See also Shawn M. Carter, *If You Invested $1,000 in Facebook at its IPO, Here's How Much You Would Have Now*, CNBC (21 November 2018) (available at https://www.cnbc.com/2018/11/21/if-you-put-1000-dollars-in-facebook-at-its-ipo-heres-what-youd-have-now.html); Yahoo Finance, *Facebook Inc Nasdaq Real Time Price* (available at https://finance.yahoo.com/quote/FB/history/).
[33] Bradford Jordan, Soohyung Kim, Nad Mark Liu, "Growth Opportunities, Short-Term Market Pressure, and Dual-Class Share Structure," 41 JOURNAL OF CORPORATE FINANCE 304-328 (2016).
[34] Martin Lipton, *The Many Myths of Lucian Bebchuk*, 93 VIRGINIA LAW REVIEW 733-758 (2007) (available at http://www.law.harvard.edu/faculty/bebchuk/pdfs/07_response_Lipton-Savitt.pdf).
[35] Oliver Hart, *Firms,* CONTRACTS AND FINANCIAL STRUCTURE (Oxford University Press, 1995), pp. 208.

Electronic copy available at: https://ssrn.com/abstract=3397880

buy) shares in a company whose managers keep control with a minority position and they do not have something that make them 'unique'. If the founders or the business they run are not found 'special' enough by investors (something that they may infer during the roadshow), the founders themselves will not have incentives to go public with dual-class shares. Therefore, they will only take the company public with dual-class structures if they think (and investors believe) that the gains associated with their particular vision and expertise can exceed the potential costs of having dual-class shares –especially in terms of moral hazard and agency problems. If the expected benefits exceed the expected costs, investors will still be interested in purchasing shares in the company even if, *ceteris paribus*, they would have of course preferred to do so in a company where the one share, one vote principle is respected.

Finally, if many countries –even those prohibiting the use of dual-class shares– allow the separation of cash-flow rights and control rights through other legal devices (e.g., preferred shares, stock pyramids, and cross-ownership structures[36]), why should dual-class shares be prohibited when they fulfil a similar goal and they actually provide a more transparent way to understand the identity and effective power help by the controllers?[37] Therefore, several reasons seem to suggest that dual-class share structures should be allowed.

4.2. The risks and costs of dual-class share structures

Despite this optimistic view of dual-class shares, not all are advantages. In fact, not even some of the benefits described above can be convincing enough. First, the existence of dual-class shares may increase agency costs between insiders (ie, directors and controlling shareholders) and outsiders (mainly minority investors) in different ways.[38] On the one hand, dual-class shares allow managers and controllers to be entrenched and therefore isolated from the market for corporate control. As a result, managers may be more relaxed when running the company, and potential acquirers may be prevented from taking over the company and implementing a potentially superior business plan. Therefore, entrenchment may also lead to an opportunity cost for public investors and society as a whole.[39] On the other hand, the existence of dual-

[36] For the analysis of stock pyramids and cross-ownerships and its importance around the world, see Rafael La Porta, Florencio López de Silanes and Robert Vishny, *Corporate Ownership Around the World*, 54 JOURNAL OF FINANCE 471 (1999); Claessens, Stijn, Simeon Djankov and Larry Lang, *The separation of ownership and control in East Asian corporations*, 58 JOURNAL OF FINANCIAL ECONOMICS 81 (2000); Lucian A. Bebchuk, Reinier Kraakman and George Triantis, *Stock Pyramids, Cross-Ownership and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights*, CONCENTRATED CORPORATE OWNERSHIP (R. Morck, ed.), pp. 445-460 (2000); Ronald W Masulis, Peter Kien Pham and Jason Zein, *Family Business Groups Around the World: Financing Advantages, Control Motivations and Organizational Choices*, 24 THE REVIEW OF FINANCIAL STUDIES 3556 (2011). For an analysis of preference shares, see Eilis Ferran and Look Chan Ho, PRINCIPLES OF CORPORATE FINANCE LAW (Oxford University Press, 2014), pp. 132-138; Pierre-Henri Conac, *The New French Preferred Shares: Moving Towards a More Liberal Approach*, 2 (4) EUROPEAN COMPANY AND FINANCIAL LAW REVIEW 487 (2005).

[37] See Aurelio Gurrea-Martínez, *Should securities regulators allow companies going public with dual-class shares*? OXFORD BUSINESS LAW BLOG, 16 January 2018 (available at https://www.law.ox.ac.uk/business-law-blog/blog/2018/01/should-securities-regulators-allow-companies-going-public-dual-class).

[38] Pointing out that deviations from the one share, one vote principle increases agency costs, and therefore it might be economically undesirable, see Lucian A. Bebchuk, *A Rent Protection Theory of Corporate Ownership and Control*, NBER WORKING PAPER NO. 7203 (1999) (available at https://www.nber.org/papers/w7203).

[39] This situation can change if a type of 'breakthrough rule', such as the one existing in Europe, is implemented. Under this rule, the company´s insiders would not be able to use their weighted voting rights to fight a hostile acquisition. See John C. Coates IV, *Ownership, Takeovers and EU Law: How Contestable Should EU Corporations Be?* ECGI LAW WORKING PAPER 11 (2003) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=424720); Guido Ferrarini, *One Share- One Vote: A European Rule?*, ECGI LAW WORKING PAPER NO. 58 (2006) (available at https://ecgi.global/sites/default/files/working_papers/documents/SSRN-id875620.pdf); Koen Geens and

Electronic copy available at: https://ssrn.com/abstract=3397880

class shares may allow insiders to extract private benefits of control regardless of the value added to the corporation. Hence, the combination of entrenchment and expropriation of corporate resources from public investors would significantly increase the agency costs of firms with dual-class shares.[40]

Second, while allowing companies to go public with dual-class share structures may sound appealing for attracting founders and IPOs, it may end up harming the market if minority investors are not properly protected or if the adoption of dual-class shares just obeys to the request of a particular company/founder. Indeed, if minority investors are not adequately protected, they may end up leaving the market. Therefore, this decision not only would destroy value for a country/stock exchange but also for firms and founders themselves since it will make it more difficult for them to raise capital. Likewise, if a regulation is amended just to attract a particular company (as the United Kingdom was considering with Saudi Aramco,[41] or Alibaba probably expected from the Hong Kong securities regulator), the reputation, credibility and independence of the regulator can be questioned by investors. And if so, they may also decide to leave the market. Under this scenario, the adoption of dual-class shares could decrease the depth of a capital market, what it can discourage many founders from choosing those markets in the first place to take their companies public. Therefore, the permissibility of dual-class shares may decrease, rather than increase, IPOs and the development of capital markets.[42]

Third, the use of dual-class shares structures may create moral hazard due to the fact that, while founders will enjoy the private benefits of control, they will not fully internalize the costs associated with value-destroying decisions.[43] In other words, since the founders only own a small percentage of the company´s share capital, they will only bear a small percentage of the company´s potential losses. As a result, they may be incentivized to engage in riskier decisions that might not be optimal in terms of expected value.

Fourth, according to the efficient capital markets hypothesis, prices reflect all publicly available information as well as the intrinsic value of a company based on their future

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Klaus J. Hopt, *The European Company Law Action Plan Revisited: Reassessment of the 2003 Priorities of the European Commission* (LEUVEN UNIVERSITY PRESS, 2010).

[40] Lucian A. Bebchuk, Reinier Kraakman and George Triantis, *Stock Pyramids, Cross-Ownership and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights*, CONCENTRATED CORPORATE OWNERSHIP (R. Morck, ed.) pp. 445-460 (2000); Lucian A. Bebchuk and Kobi Kastiel, *The Untenable Case for Dual-Class Stock*, 103 VIRGINIA LAW REVIEW 583-631 (2017) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2954630); Lucian A. Bebchuk and Kobi Kastiel, *The Lifecycle Theory of Dual-Class Structures* (2018) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3300841); Lucian A. Bebchuk and Kobi Kastiel, *The Perils of Small-Minority Controllers*, ECGI LAW WORKING PAPER NO. 434 (2018) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3128375).

[41] Caroline Binham, Dan McCrum and Hannah Murphy, *London Reforms Set to Open Door to Saudi Aramco Listing*, FINANCIAL TIMES, 13 July 2017 (available at https://www.ft.com/content/aeeb636e-67a7-11e7-9a66-93fb352ba1fe).

[42] See Aurelio Gurrea-Martínez, *Should securities regulators allow companies going public with dual-class shares*? OXFORD BUSINESS LAW BLOG, 16 January 2018 (available at https://www.law.ox.ac.uk/business-law-blog/blog/2018/01/should-securities-regulators-allow-companies-going-public-dual-class).

[43] Lucian A. Bebchuk, Reinier Kraakman and George Triantis, *Stock Pyramids, Cross-Ownership and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights*, CONCENTRATED CORPORATE OWNERSHIP (R. Morck, ed.) pp 445-460 (2000); Lucian A. Bebchuk and Kobi Kastiel, *The Untenable Case for Dual-Class Stock*, 103 VIRGINIA LAW REVIEW 583-631 (2017) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2954630); Lucian A. Bebchuk and Kobi Kastiel, *The Perils of Small-Minority Controllers*, ECGI LAW WORKING PAPER NO. 434 (2018) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3128375).

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cash-flows.[44] However, several concerns have been raised in the past years about this hypothesis.[45] Behavioral economists have shown that, due to the problems of bounded rationality[46] and certain biases, people can make mistakes. Therefore, investors might not be able to accurately price a company in the IPO stage. Or even if they do, they do not have enough information about how the company and its founders may perform or behave in the future. As a result of these asymmetries of information that may exacerbate the problem of bounded rationality, their decisions might not be as optimal as it may seem at first. And if this argument is true for the United States, there will be more reasons to believe it in countries with less sophisticated markets, actors, and investors.[47] Therefore, exclusively relying on the market to protect investors might not always be optimal, especially outside the United States.

Fifth, while the use of dual-class shares can indeed isolate firms from activist investors, this can actually destroy rather than increase value. On the one hand, shareholder activists perform a very valuable monitoring function in the market. Therefore, they can reduce agency problems. On the other hand, shareholder activist can implement some value-enhancing strategies. Finally, it is not clear whether shareholder activism leads to short-termism,[48], and, if so, if that is a problem.[49] Therefore, if shareholder activists can often increase value by reducing agency problems and promoting value-increasing strategies, and it is not clear whether they create short-termism, isolating companies from shareholder activists might not be the most desirable solution.

Finally, it should be taken into account that, even if, at an early stage, founders have a unique vision that can create value for everyone, this vision can become obsolete, or the founders can become more incompetent or unenthusiastic at some point in the future.[50] Therefore, the fact that founders might be entitled to keep running the firm *forever* might not be the most value-maximizing option for society.

5. The evidence

5.1. The impact of dual-class shares at a firm-level

[44] See Eugene Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 The Journal of Finance 383 (1970); Ronald J. Gilson and Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 Virginia Law Review 549 (1984).

[45] Eugene Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 The Journal Of Finance 383-417 (1970). Other authors, however, have pointed out the failures of the Efficient Capital Markets Hypothesis. See Robert J. Shiller, Irrational Exuberance (Princeton University Press, 2000); Werner F.M. De Bondt and Richard H. Thaler, *Does the Stock Market Over-react?* 40 Journal Of Finance 793 (1995); Andrei Shleifer, Inefficient Markets: An Introduction to Behavioural Finance (Oxford University Press, 2000).

[46] Christine Jolls, *Behavioural Law and Economics*, NBER Working Paper No. 12879 (2007) (available at https://www.nber.org/papers/w12879).

[47] Aurelio Gurrea-Martínez, *Should securities regulators allow companies going public with dual-class shares*? Oxford Business Law Blog, 16 January 2018 (available at https://www.law.ox.ac.uk/business-law-blog/blog/2018/01/should-securities-regulators-allow-companies-going-public-dual-class).

[48] Lucian A. Bebchuk, Alon Brav and Wei Jiang, *The Long-Term Effects of Hedge Fund Activism*, 115 Columbia Law Review 1085 (2015).

[49] Mark J. Roe, *Corporate Short-Termism: In the Boardroom and in the Courtroom*, 68 The Business Lawyer 977 (2013), Aurelio Gurrea-Martínez, *Shareholder Activists: A Threat for the Global Economy?*, Columbia Law School's Blog on Corporations and the Capital Markets (2016) (available at http://clsbluesky.law.columbia.edu/2016/05/13/shareholder-activists-a-threat-for-the-global-economy/).

[50] One example of this occurring would be the media company Viacom. While the dual-class shares structure allowed its founder to maintain full control of the company and helped him transform the company into a $40 billion "entertainment empire", he has since been allegedly suffering from a "profound physical and mental illness" thus raising concerns that he may not be the best leader for the company. See Lucian A. Bebchuk and Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 Virginia Law Review 585, 587-590 (2017).

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5.1.1. Evidence undermining the desirability of dual-class shares

In a pioneer empirical investigation of firms with single and dual-class shares structures in the United States, Gompers, Ishii, and Metrick found that that the value of a firm decreases as insider voting rights increase relative to cash-flow rights. Therefore, dual-class shares are associated with lower firm value.[51] In another interesting study, Smart, Thirumalai, and Zutter also concluded that dual-class firms trade at lower values than their peers following IPO, and this valuation discount persists for the subsequent 5 years. They also found shareholders react positively to share-class unifications. Therefore, the combination of both findings seems to suggest that dual-class shares destroy value.[52]

Masulis, Wang, and Xie examined how the divergence between insider voting rights and cash-flow rights affects managerial extraction of private benefits of control. They found that as the divergence widens at dual-class companies, corporate cash holdings are worth less to outside shareholders, CEOs receive higher levels of compensation, managers are more likely to make shareholder-value destroying acquisitions, and capital expenditures contribute less to shareholder value. Therefore, this study supports the hypothesis that managers with greater control rights in excess of cash-flow rights are prone to waste corporate resources to pursue private benefits at the expense of shareholders.[53]

Lauterbach and Pajuste studied the impact of share-class unification on firm value. They found that voluntary share-class unifications are associated with economically significant increases in firm value (Tobin's Q). Therefore, removing dual-class shares is beneficial to firm value, suggesting that dual-class shares can be a sign of poor governance.[54]

In a study of 675 European public companies from 11 countries, Barontini and Caprio analysed the relation between firm value and the wedge between the voting and the cash-flow rights of the largest shareholder.[55] The authors found a negative association between corporate valuation and the control-enhancing devices used by the largest shareholder. Therefore, this study also supports the hypothesis that dual-class share structures destroy value for investors.

Using a new dataset of corporate voting-rights from 1971 to 2015, Kim and Michaely found that as dual-class firms mature, their valuation declines, and they become less efficient in their margins, innovation, and labour productivity compared to their single-class counterparts.[56] Voting premiums increase with firm age, suggesting that private benefits increase over maturity. On the basis of these findings, the authors suggest that

[51] Gompers, Paul A., Joy Ishii, and Andrew Metrick. *Extreme Governance: An Analysis of Dual-Class Firms in the United States*, 23 REVIEW OF FINANCIAL STUDIES 3 (2010).

[52] Scott B. Smart, Ramabhadran S. Thirumalai and Chad J. Zutter, *What's In a Vote? The Short and Long-Run Impact of Dual-Class Equity on IPO Firm Values*, 45 JOURNAL OF ACCOUNTING AND ECONOMICS 94-115 (2008).

[53] Ronald W. Masulis, Cong Wang, and Fei Xie, *Agency Problems at Dual-Class Companies*, 64(4) THE JOURNAL OF FINANCE 1697 (2009).

[54] Beni Lauterbach and Anete Pajuste, *The Long-Term Valuation Effects of Voluntary Dual-Class Share Unifications*, 31 JOURNAL OF CORPORATE FINANCE 185 (2015).

[55] Roberto Barontini and Lorenzo Caprio, *The Effect of Family Control on Firm Value and Performance*, ECGI FINANCE WORKING PAPER NO. 88 (2005) (available athttps://papers.ssrn.com/sol3/papers.cfm?abstract_id=675983).

[56] Hyunseob Kim and Roni Michaely, *Sticking Around Too Long? Dynamics of the Benefits of Dual-Class Voting*, ECGI FINANCE WORKING PAPER NO. 590 (2019) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3145209).

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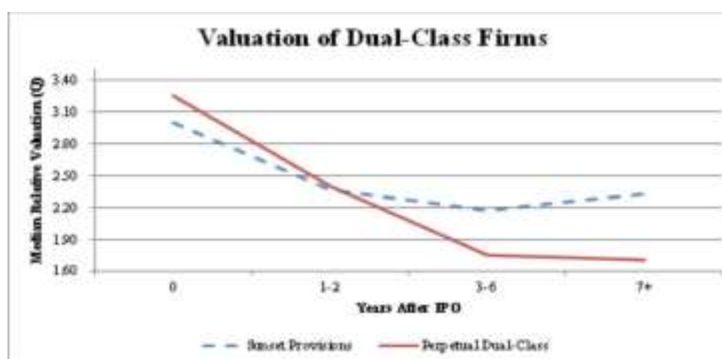
effective, time-consistent sunset provisions should be based on age or on inferior shareholders' periodic right to eliminate dual-class voting.

Cremers, Lauterbach, and Pajuste have recently studied the long-term performance of companies with dual-class shares.[57] They have found that, while companies with dual-class firms have higher valuation at IPO (Tobin's Q), premium disappears 6 to 9 years later. Therefore, the desirability of dual-class shares decreases over time. This leads the authors to speak about a 'life cycle' of dual-class shares. This study is consistent with Barah, Forst and Via,[58] who show that, even though insider control at multi-class firms exhibits a positive association with innovation output that exceeds the costs of the voting misalignment, this effect changes over time. Therefore, they conclude that the reducing positive effects of disproportionate insider control post-IPO supports the call for 'sunset provisions' to convert dual class shares to single class within a certain period of time post-IPO.

The underperformance of firms with perpetual dual-class shares has also been shown in a recent empirical study conducted by SEC Commissioner Robert J. Jackson.[59] As shown in table 1, Jackson shows that firms with perpetual dual-class shares underperform relative to their peers after a certain period of time. Therefore, he concludes that a mandatory time-based sunset clause may seem desirable.

Table 1. Valuation of dual-class firms over time



Source: Jackson, *Perpetual Dual-Class Stock: The Case Against Corporate Royalty* (2018)

5.1.2. Evidence supporting the use of dual-class shares

Not all studies, however, suggest that dual-class (or perpetual dual-class) shares can be undesirable. In an empirical study conducted by Jordan, Kim, and Liu, the authors showed that firms with dual-class shares face lower short-term market pressures, have more growth opportunities and obtain higher market valuations than single-class firms.[60] Likewise, Anderson, Ottolenghi and Reeb found that firms with dual-class

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[57] Martin Cremers, Beni Lauterbach and Anete Pajuste, *The Life-Cycle of Dual Class Firm Valuation*, ECGI FINANCE WORKING PAPER NO. 550 (2018) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3062895).

[58] Lindsay Baran, Arno Forst, and M. Tony Via, *Dual Class Share Structure and Innovation* (2018) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3183517).

[59] Robert J. Jackson Jr, *Perpetual Dual-Class Stock: The Case Against Corporate Royalty*, U.S. SECURITIES AND EXCHANGE COMMISSION (2018) (available at https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty).

[60] Bradford Jordan, Soohyung Kim, Nad Mark Liu, *Growth Opportunities, Short-Term Market Pressure, and Dual-Class Share Structure*, 41 JOURNAL OF CORPORATE FINANCE 304-328 (2016).

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shares where larger, older and better operating performers than their single-class peers. [61]

Other studies have suggested that giving more voting power to shareholders who are better informed while reducing the voting power to those less informed, including passive index funds, can be efficient.[62] Therefore, it will make sense to let founders with knowledge and expertise run the company even if investors pay a discounted price in exchange for waiving their voting rights. [63]

In another interesting study, Kim and Michaely shown that the value of mature firms with dual-class shares decline overtime. However, they found that young dual-class firms trade at a premium and operate at least as efficiently as young single-class firms. Therefore, the use of dual-class shares structure can be desirable, at least for young firms. [64]

Finally, collecting evidence from Canadian firms, other authors have shown that firms with dual-class shares outperform their peers over 5, 10, and 15 year periods.[65] Moreover, they use of dual-class share structure may create other benefits for a local economy – especially in terms of protectionism, attraction of IPOs, and development of the financial industry.[66] Therefore, it will make sense to allow dual-class share structures.

5.1.3. Conclusion

Most empirical studies seem to show that the value of companies with dual-class shares decreases over time. Therefore, the evidence seems to favour the position of those advocating for the imposition of *mandatory time-based sunset clauses*.[67] In my opinion, however, there are reasons to be sceptical about this proposal.[68]

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[61] Ronald Anderson, Ezgi Ottolenghi, and David Reeb, *The Dual Class Premium: A Family Affair*, FOX SCHOOL OF BUSINESS RESEARCH PAPER NO. 17-021 (2017) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3006669&download=yes).

[62] Dorothy S. Lund, *Nonvoting Shares and Efficient Corporate Governance*, 71 STANFORD LAW REVIEW (forthcoming 2019). In favour of empowering shareholders, see Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARVARD LAW REVIEW 833 (2005). For arguments against, see Stephen M. Bainbridge, *Director Primacy and Shareholder Empowerment*, 119 HARVARD LAW REVIEW (2006).

[63] Dorothy S. Lund, *Nonvoting Shares and Efficient Corporate Governance*, 71 STANFORD LAW REVIEW (forthcoming 2019).

[64] Hyunseob Kim and Roni Michaely, *Sticking Around Too Long? Dynamics of the Benefits of Dual-Class Voting*, ECGI WORKING PAPER NO. 590 (2019) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3145209).

[65] Yvan Allaire, *Enough with the Shibboleth on Dual Class of Shares*, Le MÉDAC (2016), pp 3 (available at https://medac.qc.ca/documentspdf/articles/2016-05_yvan_allaire_vote_multiple_anglais.pdf).

[66] Yvan Allaire, *Enough with the Shibboleth on Dual Class of Shares*, Le MÉDAC (2016), pp 3. (available at https://medac.qc.ca/documentspdf/articles/2016-05_yvan_allaire_vote_multiple_anglais.pdf).

[67] Those advocating for this reform include SEC Commissioner Robert J. Jackson, Jr., Professors Lucian Bebchuk and Kobi Kastiel, and the Council of Institutional Investors. See Robert J Jackson Jr, *Perpetual Dual-Class Stock: The Case Against Corporate Royalty*, U.S. SECURITIES AND EXCHANGE COMMISSION (2018) (available at https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty); Lucian A. Bebchuk and Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 VIRGINIA LAW REVIEW 585 (2017); Council of Institutional Investors, *Petition to NYSE on Multiclass Sunset Provisions*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (2018) (available at https://corpgov.law.harvard.edu/2018/11/02/petition-to-nyse-on-multiclass-sunset-provisions/); John C. Coffee, *Dual Class Stock: The Shades of Sunset*, THE CLS BLUE SKY BLOG (2018), http://clsbluesky.law.columbia.edu/2018/11/19/dual-class-stock-the-shades-of-sunset/.

[68] Reflecting his opposition to the idea of restricting dual-class shares, see also Zohar Goshen, *Against Mandatory Sunset for Dual Class Firms*, THE CLS BLUE SKY BLOG (2018) (available at http://clsbluesky.law.columbia.edu/2019/01/02/against-mandatory-sunset-for-dual-class-firms/).

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First, the empirical evidence about dual-class shares is not conclusive.[69] While most studies indeed found that the value of dual-class firms declined after a certain period of time, they also show that the same firms may enjoy higher valuations at the IPO stage and they can also generate other benefits, including higher levels of innovation, more protection against short-term market pressure, and promotion of the local industry.[70]

Second, as some authors have pointed out,[71] it should be taken into account that until Google went public in 2004, most companies going public with dual-class shares were family-owned, media companies.[72] In fact, the percentage of *non-tech* companies, compared to those with a technology-based business, going public with dual-class shares has been traditionally higher in the United States at least until 2014. Since then, the percentage of tech companies going public with dual-class shares has exceeded their non-tech peers.[73] Therefore, many empirical studies analysing the desirability of dual-class shares may not have captured the higher idiosyncratic value probably created by founders of tech firms. As a result, perhaps more research should be needed *across industries* before coming up with such an interventionist solution like the imposition of time-based sunset clauses. On average, it is true that dual-class firms seem to underperform their peers in the long-term. But perhaps this result differs across industries,[74] and innovative, technology-based companies may end up outperforming their peers with single-class structures.[75]

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[69] Some studies have actually shown that dual-class firms outperform their peers. Likewise, other studies have found that multi-class common equity structure with unequal voting rights neither increases nor decreases a company's annualized return on invested capital. See Gabriel Morey, *Multi-Class Stock and Firm Value*, COUNCIL OF INSTITUTIONAL INVESTORS (2017) (available at https://www.cii.org/files/publications/misc/05_10_17_dual-class_value_study.pdf).

[70] Yvan Allaire, *Enough with the Shibboleth on Dual Class of Shares,* Le MÉDAC (2016), pp. 4 (available at https://medac.qc.ca/documentspdf/articles/2016-05_yvan_allaire_vote_multiple_anglais.pdf); Lindsay Baran, Arno Forst and M. Tony Via, *Dual Class Share Structure and Innovation,* WORKING PAPER (2018) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3183517).

[71] See David J. Berger and Laurie Simon Hodrick, *Are Dual-Class Companies Harmful to Stockholders? A Preliminary Review of the Evidence*, HARVARD LAW FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (2018) (available at https://corpgov.law.harvard.edu/2018/04/15/are-dual-class-companies-harmful-to-stockholders-a-preliminary-review-of-the-evidence/).

[72] David J. Berger and Laurie Simon Hodrick, *Are Dual-Class Companies Harmful to Stockholders? A Preliminary Review of the Evidence*, HARVARD LAW FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (2018) (available athttps://corpgov.law.harvard.edu/2018/04/15/are-dual-class-companies-harmful-to-stockholders-a-preliminary-review-of-the-evidence/).

[73] In 2014, 11.8% of non-tech companies went public with dual-class shares, while 11.3% of tech companies went public with dual-class shares. In 2015, 10.1% of non-tech companies went public with dual-class shares while 38.9% of tech companies went public with dual class shares. More recently, in 2017, 21.8% of non-tech companies went public with dual-class shares while 43.3% of tech companies went public with dual-class shares. CFA Institute, *Dual-Class Shares: The Good, The Bad and The Ugly* (available at https://www.cfainstitute.org/-/media/documents/survey/apac-dual-class-shares-survey-report.ashx). See also Ritter, Jay R, Initial Public Offerings Updated Statistics (2018) (available at https://site.warrington.ufl.edu/ritter/files/2018/07/IPOs2017Statistics_July11_2018.docx).

[74] In my opinion, the desirability of dual-class shares depends across firms and founders. However, from a policy perspective, regulators should clarify whether they allow, restrict or prohibit dual-class shares, and this is actually the purpose of this paper.

[75] This is probably the rationale behind the reform of dual-class shares in Hong Kong. According to the new regulatory framework for dual-class shares in Hong Kong, only 'innovative' firms can go public with dual-class shares. This provision is probably explained by the belief that founders of these firms can create more value. See Hong Kong Exchange, *Listing Regime Reforms for Dual-Class Share Structure and Biotech Industry- Summary* (April 2018) at p 8 (available at https://www.hkex.com.hk/-/media/HKEX-Market/News/Research-Reports/HKEx-Research-Papers/2018/CCEO_DualClass_201804_Summary_e.pdf?la=en). In my opinion, however, while the rationale of this approach can be easily understood, it would have been more appropriate if, before implementing such a significant reform, the Hong Kong securities regulator had have conducted an empirical study analysing whether innovative firms actually outperform their peers, and what they mean by 'innovative firm'. In the 2014 Concept Paper, the Hong Kong Exchange considered that "innovative", according to the Oxford English Dictionary, means "adjective (of a product, idea, etc.) featuring new

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Third, the desirability of dual-class shares can not only differ across firms and industries but also across countries. Therefore, when assessing whether dual-class shares firms outperform or underperform their peers with single-class share structures, regulators should observe the empirical evidence existing in their *own* markets and jurisdictions even if studies from other jurisdictions can be relevant for the discussion and the construction of the empirical study.

Finally, and perhaps more importantly, it should be taken into account that, in the absence of dual-class shares, some firms included in these empirical studies would have never gone public.[76] Therefore, *even if* it were unequivocally shown that firms with dual-class shares structures underperform their peers, there would still be reasons to allow companies with dual-class shares. Otherwise, not only may investors be prevented from enjoying the benefits of investing in successful businesses while helping them fund their operations and growth, but regulators could also reduce the liquidity, efficiency, and depth of the market.

5.2. The implementation of dual-class shares: a powerful tool to attract IPOs? Early Evidence from Hong Kong and Singapore

According to the available data as of 31 May 2019, only 2 companies went public with dual-class shares in Hong Kong since the reform was implemented in 2018,[77] and there are no records of dual-class firms going public in Singapore since 26 June 2018, when the reform came into effect.

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methods, advanced and original". Although it also noted that determining whether a company is "innovative" would be subjective and the definition can change over time. Nonetheless, the intention behind including this definition was to "foster the listing of exceptional companies that may have transformative effect on their industry or society in general and that could, in time, produce significant benefits for the market as a whole and to the public". See Hong Kong Exchange, *Concept Paper Weighted Voting Rights* (2014) (available at https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2011-to-2015/August-2014-Weighted-Voting-Rights/Consultation-paper/cp2014082.pdf).

[76] Keeping control is one of the most important factors to stay private. See survey to CFOs conducted by James C. Brau and Stanley E. Fawcett, *Initial Public Offerings: An Analysis of Theory and Practice*, 61 THE JOURNAL OF FINANCE 399-436 (2006); Tomáš Meluzín, Marek Zinecker, Adam P. Balcerzak and Michal B. Pietzrak, *Why Do Companies Stay Private? Determinants for IPO Candidates to Consider in Poland and the Czech Republic*, 56 (6) EASTERN EUROPEAN ECONOMICS 471 (2018).

[77] These companies are Xiami Corporation and Meituan Dianping. See_Hong Kong Exchange, *Market Statistics 2018* (2018) (available at https://www.hkex.com.hk/-/media/HKEX-Market/Market-Data/Statistics/Consolidated-Reports/Annual-Market-Statistics/2018-market-statisitcs.pdf). A third company, Alibaba, has recently announced that it is considering a secondary listing in Hong Kong. See Clay Chandler, *Why Alibaba's Hong Kong IPO May Signal a Chinese Retreat from Wall Street*, FORTUNE, 29 May 2019 (available at http://fortune.com/2019/05/29/alibaba-hong-kong-secondary-ipo/). In Singapore, there have been no companies that have gone public with dual-class shares yet, but some companies (such as FWD Group) have considered the possibility of listing on the SGX with dual-class shares. See Bloomberg, *FWD Eyeing Dual-Class IPO Here: Sources*, 1 Aug 2018 (available at https://www.straitstimes.com/business/companies-markets/fwd-eyeing-dual-class-ipo-here-sources). Institutional investors have commented that these changes by the SGX and HKEX are "responding to a 'race to the bottom' that U.S. stock markets started". See Amy Borrus, *Commentary: Dual-Class Structures Rob Voices of Shareholders*, PENSIONS & INVESTMENTS ONLINE, 1 April 2019 (available at https://www.pionline.com/article/20190401/PRINT/190409997/commentary-dual-class-structures-rob-voices-of-shareholders). Similarly, institutional investors have criticised the HKEX's approach to dual-class shares, arguing that "even with well-intentioned safeguards, including a prohibition on the transfer of super voting rights and the loss of super voting rights upon death or departure, the consultation presents a solution that 1) holds the door open for substantial long term principal agent challenges, and 2) creates significant subjective processes for the HKEX listing committee based on vague criteria, creating new discretionary burdens for the HKEX and uncertainty in the market": Council of Institutional Investors, *Emerging and Innovative Companies CP*, 22 March 2018 (available at https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/February-2018-Emerging-and-Innovative-Sectors/Responses-(April-2018)/cp201802r_147.pdf).

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While it is too early to judge the effectiveness of the implementation of dual-class shares in Hong Kong and Singapore for the attraction of IPOs, and a proper assessment of these reforms would require controlling for a variety of factors, there are reasons to be optimistic about the success of the new regulatory framework for dual-class shares in Hong Kong and Singapore. On the one hand, these jurisdictions have adopted a reasonable, middle ground approach to deal with dual-class shares.[78] Therefore, even though some further reforms can still be implemented to enhance the protection of minority investors,[79] the implementation of dual-class shares can make founders better off without generating many costs for minority shareholders. On the other hand, the capital markets and venture capital industry in Hong Kong and Singapore have been growing very rapidly in the past years. Therefore, it would be reasonable to expect that more companies might go public in these leading financial centres.

Therefore, even though it is unclear whether this reform will help Singapore and Hong Kong compete with New York for the attraction of IPOs (especially in the context of large non-US firms), the implementation of dual-class shares in these jurisdictions will make very unlikely to observe what happened with Alibaba and Manchester United. From now on, companies seeking to go public in Hong Kong and Singapore will no longer be forced to end up in New York *just* because of their inability to go public with dual-class shares in the two leading financial centres in Asia.

6. Regulatory approaches to deal with dual-class shares

6.1. Prohibition

Many countries around the world, including the United Kingdom,[80] Germany, Spain, Colombia, and Argentina, still prohibit the use of dual-class shares. In my opinion, the strict adherence to the one share, one vote might be justified for three possible factors: (i) economic reasons associated with moral hazard, entrenchment and agency problems; (ii) legal reasons mainly related to fairness and equal treatment of shareholders; and (iii) influence of lobbies (mainly institutional investors).

From an economic perspective, dual-class shares have been criticized on two primary grounds. First, the use of dual-class creates minority controlling shareholders'.[81] Therefore, even if these shareholders have their reputation and part of their wealth at risk, they do not internalize all the costs of their decisions.[82] As a result, they might not

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[78] See Tay Peck Gek, *US Bourses Can Take a Leaf from Singapore DCS Framework: SEC Commissioner*, THE BUSINESS TIMES (25 September 2018) (available at https://www.businesstimes.com.sg/companies-markets/us-bourses-can-take-a-leaf-from-singapore-dcs-framework-sec-commissioner) and Barclay Ballard, *The Battle to be Top of the Stocks*, WORLD FINANCE (11 April 2018) (available at https://www.worldfinance.com/strategy/the-battle-to-be-top-of-the-stocks).

[79] For example, Singapore might consider the possibility of implementing minority approvals for related party transactions, while both Hong Kong and Singapore may consider the implementation of minotiry-appointed directors and class actions. Thus, they would provide higher protection to outside investors.

[80] Dual-class shares are prohibited for companies listing on the UK's Premium Listing. A Premium Listing means the company is expected to meet the UK's highest standards of regulation and corporate governance. According to Premium Listing Principle 3, all equity shares in a class that has been admitted to premium listing must carry an equal number of votes on any shareholder vote. See Financial Conduct Authority, *Listing Principles and Premium Listing Principles* (available at https://www.handbook.fca.org.uk/handbook/LR/7.pdf).

[81] Bebchuk and Kobi Kastiel, *The Perils of Small-Minority Controllers*, ECGI LAW WORKING PAPER 434 (2018) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3128375).

[82] Lucian A. Bebchuk, Reinier Kraakman and George Triantis, *Stock Pyramids, Cross-Ownership and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights*, CONCENTRATED CORPORATE OWNERSHIP (R. Morck, ed.) pp. 445-460 (2000); Lucian A. Bebchuk and Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class* Stock, 103 VIRGINIA LAW REVIEW 685 (2017); Lucian

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have the right incentives to make the most value-maximizing decisions in terms of expected value. Namely, as they will not internalize all the costs of their decisions, they might incur in a problem of over-investment.[83] Second, the existence of dual-class shares may entrench current insiders from the market for corporate control.[84] Therefore, since it will be more difficult to remove the existing controllers, not only will the shareholders be prevented from having other controllers with a potentially superior business plan but they can also be exposed to managerial opportunism and laziness.[85]

A second argument potentially provided to explain the prohibition of dual-class shares can be based on the concept of equality among shareholders.[86] According to this argument, dual-class shares should be prohibited on the basis of the 'one share, one vote' principle that should prevail in corporate law. In my opinion, however, this justification does not seem very convincing. As it has been mentioned, there are many ways to circumvent the one share one vote principle, including the use of stock pyramids and cross-ownership. Moreover, even if all deviations of the one share one vote principles were prohibited, it is not clear whether this is the most efficient outcome for firms.[87] Therefore, this argument seems very vague.

Finally, another aspect sometimes omitted when studying corporate law is the role played by lobbies. Some authors have argued that the director-friendly and shareholder-friendly takeover law, existing in the United States and the United Kingdom respectively, is partially explained by the corporate ownership structures existing in these countries.[88] In the United States, the traditional existence of dispersed ownership structures with small and rationally apathetic shareholders has made managers very powerful.[89] Institutional investors, on the other hand, have been present in the United Kingdom for many decades.[90] Therefore, even though the United Kingdom is also a jurisdiction with dispersed ownership structure,[91] shareholders were

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A. Bebchuk and Kobi Kastiel, *The Lifecycle Theory of Dual-Class Structures* (2018) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3300841); Lucian A. Bebchuk and Kobi Kastiel, *The Perils of Dell's Low-Voting Stock* (2019), (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3285296); Andrew William Winden, *Sunrise, Sunset: An Empirical and Theoretical Assessment of Dual-Class Stock Structures*, ROCK CENTER FOR CORPOARTE GOVERNANCE AT STANFORD UNIVERSITY WORKING PAPER NO. 288 (2018) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3001574).

[83] The concept of 'overinvestment' refers to those situations in which projects with a negative net present value are being pursued, usually because even though they are not the most value-maximizing projects in terms of expected value, they can yield very high returns in the unlikely event of success. See Richard A. Brealey, Stewart C. Myers and Franklin Allen, PRINCIPLES OF CORPORATE FINANCE (McGraw-Hill Irwin, 10th Edition, 2011), p. 291.

[84] For an analysis and importance of the market for corporate control, see Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 THE JOURNAL OF POLITICAL ECONOMY 110 (1965); Frank H. Easterbrook y Daniel R. Fischel, *The Proper Role of the Target´s Management in Responding to a Tender Offer,* 94 HARVARD LAW REVIEW 1161 (1981).

[85] Lucian A. Bebchuk and Kobi Kastiel, *The Perils of Small-Minority Controllers*, ECGI LAW WORKING PAPER 434 (2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3128375.

[86] Guido Ferrarini, *One Share - One Vote: A European Rule?*, ECGI LAW WORKING PAPER 58 (2006) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=875620).

[87] See Oliver D. Hart and Sanford J. Grossman, *One Share/One Vote and the Market for Corporate Control*, WORKING PAPER NO. 2347 (1987) (available at https://www.nber.org/papers/w2347.pdf); Guido Ferrarini, *One Share - One Vote: A European Rule?*, ECGI LAW WORKING PAPER 58 (2006) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=875620).

[88] John Armour and David A. Skeel, *The Divergence of U.S. and UK Takeover Regulation*, 95 GEORGETOWN LAW JOURNAL 1727 (2007).

[89] Mark Roe, STRONG MANGERS, WEAK SHAREHOLDERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (Princeton Univeristy Press, 1994).

[90] Rafael La Porta, Florencio López de Silanes, Andrei Shleifer and Robert Vishny, *Law and Finance*, 106 JOURNAL OF POLITICAL ECONOMY 1113 (1998); Brian R. Cheffins, *Corporate Ownership and Control: British Business Transformed*, OXFORD UNIVERSITY PRESS (2008).

[91] Rafael La Porta, Florencio López de Silanes and Robert Vishny, *Corporate Ownership Around the World*, 54 JOURNAL OF FINANCE 471 (1999); Claessens, Stijn, Simeon Djankov and Larry Lang, *The*

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more informed, powerful and coordinated than in the United States. As a result, shareholders have been in a better position to advocate for a more shareholder-friendly takeover law. This may explain not only the UK approach to dual-class shares, but also many provisions and developments, including the takeover law and even the existence of the first Corporate Governance – precisely designed to protect (powerful) shareholders from managerial opportunism.

While the prohibition of dual-class shares in the United Kingdom can be explained –at least in part– by this latter argument based on the role of lobbies, this is probably untrue in other countries banning companies going public with dual-class shares such as Spain, Germany, Colombia and Argentina. In my opinion, the regulatory model adopted by these countries is probably due to the second reason mentioned above – that is, the false respect for the one share one vote and the vague concept of fairness– perhaps in conjunction with other factors, including a more traditional legal scholarship[92], and the tendency to replicate many practices from the United Kingdom.[93] Indeed, on the one hand, the lack of influence of the law and economics literature in these countries makes it very unlikely that the prohibition is based on the first, economic argument.[94] On the other hand, it is also very unlikely that the lobbies of families and other controlling shareholders existing in these countries were in favour of the prohibition something that would make them even more powerful, unless they perceived that this reform, linked to the problems of tunnelling already existing in many of these countries (e.g., Mexico, Italy, Spain)[95], the controlling families may have wanted to keep the one share one vote as a way to have more access to finance.

6.2. Permission

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separation of ownership and control in East Asian corporations, 58 JOURNAL OF FINANCIAL ECONOMICS 81 (2000); Brian R. Cheffins, *Corporate Ownership and Control: British Business Transformed*, OXFORD UNIVERSITY PRESS (2008) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1304194); Colin Mayer and Julian Franks for UK Corporate ownership structures: Colin Mayer and Julian Franks, *Evolution of Ownership and Control Around the World: The Changing Face of Capitalism*, FINANCE PAPER NO. 503 (2017) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2954589).

[92] The influence of traditional legal scholars in these countries undermines the use of economics, finance, and other disciplines to explain and improve the design of corporate law. See Aurelio Gurrea Martínez, *The Colombian Simplified Stock Corporation as a Paradigm of Legal Innovation: Role of Legal Scholars in Society,* in Francisco Reyes (eds.), SIMPLIFIED STOCK CORPORATION (Legis, 2018). Therefore, it is very unlikely that the prohibition of dual-class shares is based on economic arguments such as moral hazard and entrenchment.

[93] This is particularly true in the field of corporate governance. Despite the fact that the primary corporate governance problem existing in the UK corporation has been the risk of opportunism of managers vis-à-vis shareholders while the primary corporate governance in a controlled firms is the risk of opportunism of the controlling shareholder vis-à-vis outside investors, the UK Corporate Governance Code – and more generally the development of UK corporate and takeover law- has been very influential in Continental Europe, Asia and Latin America, which are actually countries with concentrated ownership structures and controlling shareholders. Therefore, it seems that legal transplant without further analysis could also help explain the corporate governance provisions existing in many countries.

[94] For the lack of influence of the law and economics literature in these countries, see Nuno Garoupa et al, *A Law and Economics Perspective on Legal Families*, ILLINOIS PUBLIC LAW AND LEAL THEORY RESEARCH PAPER NO. 13-11; ILLINOIS PROGRAM IN LAW, BEHAVIOUR AND SOCIAL SCIENCE PAPER NO. LBSS13-01 (2012) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2104443), and Gurrea Martínez, *The Colombian Simplified Stock Corporation as an Example of Legal Innovation: Thoughts about the Role of Legal Scholars*, INSTITUTO IBEROAMERICANO DE DERECHO Y FINANZAS (2018) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3097775).

[95] See Luca Enriques and Paolo Volpin, *Corporate Governance Reforms in Continental Europe*, 21 THE JOURNAL OF ECONOMIC PERSPECTIVES 117-140 (2006) (available at https://www.jstor.org/stable/30033704?seq=1#page_scan_tab_contents); Rafael La Porta, Lopez de Silanes and Andrei Shleifer, *The Economic Consequences of Legal Origins*, 46:2 JOURNAL OF ECONOMIC LITERATURE (2008) (available at http://faculty.tuck.dartmouth.edu/images/uploads/faculty/rafael-laporta/Economic_Consequences_JEL_final.pdf).

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Many countries around the world, including the United States, Sweden, Canada, and the Netherlands, allow companies going public in a very permissible way – that, without being subject to many restrictions. In my opinion, this regulatory model can be explained by three primary reasons: (i) economic factors mainly related to efficiency gains created by founders and the ability of the market to create optimal governance structures at the IPO stage; (ii) the influence of lobbies (mainly directors); and (iii) regulatory competition and attraction of IPOs.

First, from an economic perspective, it can be optimal to let the founders keep running the firm once the company is already public. Sometimes, they have a unique set of skills or a vision that nobody else can replicate.[96] Therefore, prohibiting founders from pursuing their vision can be harmful for the shareholders. Additionally, market forces discourage value-destroying founders from going public with dual-class shares. Since the market would price the company and its founders, insiders should not have incentives to go public with dual-class shares unless they think (and investors believe) that they can create value.

Second, as it has been mentioned, directors have seemed to play a great role in the design of corporate law in the United States. Therefore, taking into account that many directors of start-ups are also their founders, they may have lobbied to make a pro-founder jurisdiction. Moreover, the US –and particularly Silicon Valley– has positioned itself as a leading entrepreneurial centre. Therefore, it would be more consistent with this vision to allow founders to keep pursuing their ventures. In other countries adopting this permissive approach, as in the case of Sweden, the explanation is even more straightforward: since Sweden is a country with many family-owned firms[97], the controlling families may have pushed for this reform. In fact, this argument has been made by some authors in the context of takeover law in Continental Europe.[98]

Third, this regulatory approach can also be explained by the desire to attract IPOs and become a competitive stock exchange. As it has been mentioned, the fear of losing control is one of the most important reasons for founders to keep their companies private.[99] Thus, the use of dual-class shares may incentivize founders to go public, what it can be desirable not only for both founders (since they will be in a position to raise more money) and investors (due to the fact that they may enjoy part of the profits of a successful, growing company) but also for the market, the financial industry, and the economy as a whole. Therefore, allowing dual-class shares can be a way to face the tough regulatory competition existing nowadays for the attraction of IPOs. In fact, this seems to be the reason behind the recent move of Hong Kong and Singapore to allow companies going public with dual class shares.

6.3. Restrictions

Finally, other countries have opted for an intermediate approach. Under this model, companies can go public with dual-class shares provided that they meet certain

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[96] Zohar Goshen and Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE LAW JOURNAL (2016).

[97] Carl Magnus Bjuggren, Dan Johansson and Hans Sjögren, *A Note on Employment and Gross Domestic Product in Swedish Family-Owned Businesses: A Descriptive Analysis*, 24(4) FAMILY BUSINESS REVIEW 362-371 (2011) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2333583).

[98] Marco Ventoruzzo, *Takeover Regulation As a Wolf in Sheep's Clothing: Taking UK Rules to Continental Europe*, PENN STATE LEGAL STUDIES RESEARCH; BOCCONI LEGAL STUDIES RESEARCH PAPER NO. 02 (2008), (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1084429); see also John Armour and David Skeel, *Who Writes the Rules for Hostile Takeovers, and Why?- The Peculiar Divergence of US and UK Takeover Regulation*, 95 GEORGETOWN LAW JOURNAL 1727 (2007).

[99] James C. Brau and Stanley E. Fawcett, *Initial Public Offerings: An Analysis of Theory and Practice*, 61 THE JOURNAL OF FINANCE 399-436 (2006).

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requirements. This approach has recently been adopted by Hong Kong and Singapore in an attempt to compete with other financial centres (particularly New York) for the attraction of IPOs, after seeing how companies like Alibaba – the biggest IPO in the history[100]- decided to go public in New York just because they were unable to go public with dual-class shares in Hong Kong.[101]

The requirements potentially imposed to companies seeking to go public with dual-class shares can be classified in three primary groups: (i) legal and corporate governance standards; (ii) sunset clauses; and (iii) maximum differential voting rights.

In terms of legal and corporate governance standards, a country allowing companies going public with dual-class shares –especially if the country suffers from problems of tunnelling– should make sure that minority investors are not harmed by this policy. For this reason, it would make sense to adopt dual-class shares in conjunction with a set of legal rules seeking to enhance the protection of minority investors, especially if they are not protected enough. These protections may consist of corporate governance rules including the imposition of minority-appointed directors,[102] the need to ratify independent directors by minority shareholders,[103] or minority-approval for related party transactions,[104] or the use of other legal devices such as the use of class actions.[105]

The imposition of sunset clauses can also serve a reasonable middle ground for the regulation of dual-class shares. If sunset clauses were adopted, countries would require companies to include a contractual condition (sunset provision) specifying certain events that, once triggered, make the dual-class shares disappear unless a majority of minority investors decides otherwise.[106] There are many different types of events, and therefore sunset clauses. For instance, a country may decide to impose

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[100] Alibaba raised $25 billion from its IPO: Ryan Mac, Liyan Chen and Brian Solomon, *Alibaba Claims Title for Largest IPO Ever With Extra Share Sales*, FORBES (22 September 2014) (available at https://www.forbes.com/sites/ryanmac/2014/09/22/alibaba-claims-title-for-largest-global-ipo-ever-with-extra-share-sales/#5ade8b5d8dcc). See also New York Stock Exchange, *Alibaba Lists on the NYSE* (September 2014) (available at https://www.nyse.com/network/article/Alibaba-Lists-on-the-NYSE).

[101] Christopher W. Betts, *Hong Kong v New York: The Competition for Chinese Tech IPOs*, SKADDEN (2014) (available at https://www.skadden.com/insights/publications/2014/10/hong-kong-v-new-york-the-competition-for-chinese-t).

[102] Maria Lucia Passador, *List Voting's Travels: The Importance of Being Independent in the Boardroom*, 24 FORDHAM JOURNAL OF CORPORATE AND FINANCIAL LAW 105 (2018); Aurelio Gurrea-Martínez, *Towards a credible system of independent directors in controlled firms*, IBERO-AMERICAN INSTITUTE FOR LAW AND FINANCE WORKING PAPER SERIES NÚM. 1 (2019) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3380868).

[103] In the UK, independent directors in controlled firms are elected by two majorities: (i) a majority of the shareholders' meeting, and (ii) a majority of independent shareholders. See Financial Conduct Authority, *Listing Rules, Chapter 9: Continuing Obligations, 9.2.2.E* (available at https://www.handbook.fca.org.uk/handbook/LR/9/2.pdf). See also Aurelio Gurrea-Martinez, *Towards a credible system of independent directors in controlled firms*, IBERO-AMERICAN INSTITUTE FOR LAW AND FINANCE WORKING PAPER SERIES NÚM. 1 (2019) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3380868).

[104] This system is used in several jurisdictions, including Hong Kong and Israel. See Jesse M Fried, Ehud Kamar, Yishay Yafeh, *The Effect of Minority Veto Rights on Controller Tunnelling*, LAW WORKING PAPER NO. 385 (2018) (available at https://ecgi.global/sites/default/files/working_papers/documents/finalfriedkamaryafeh_0.pdf).

[105] CFA Institute, *Dual-class Shares: The Good, the Bad, and the Ugly, A Review of the Debate Surrounding Dual-Class Shares and Their Emergence in Asia Pacific* (2018) pp. 6 (available at https://www.cfainstitute. Org/-/media/documents/survey/apac-dual-class-shares-survey-report.ashx). A lack of class action suits in Hong Kong was also one reason why the Hong Kong Exchange decided not to allow dual-class shares in 2014. See see Hong Kong Exchanges and Clearing Limited, *Concept Paper Weighted Voting Rights* (2014), pp. 20-22 (available at https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2011-to-2015/August-2014-Weighted-Voting-Rights/Consultation-paper/cp2014082.pdf).

[106] See Lucian A. Bebchuk and Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class* Stock, 103 VIRGINIA LAW REVIEW 585, 618-622 (2017).

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time-based sunset provisions.[107] Under these sunset clauses, the dual-class shares will disappear after a certain period of time, unless a majority of minority investors decide otherwise. Alternatively, a country may opt for an *event-based sunset clause*. These events may include a variety of situations, including the founder´s death or incapacity, the transfer of shares to third parties, or the failure to meet certain requirements in terms of ownership in the company´s share capital.

The time-based sunset clause seeks to respond to the so-called 'life cycle' of dual-class shares, that is, the empirical evidence suggesting that the value of firms with dual-class share structures decline in value after a certain period of time.[108] The event-based sunset clauses may fulfil a different goal depending on its nature and structure. For example, if the use of dual-class shares is justified (at least in part) because of the 'unique' vision that some founders may have, it would not make sense to keep the dual-class shares structure if the founders die, transfer their shares, or are incapacitated. Likewise, by requiring a minimum percentage of the company´s equity (as other sunset clauses do), the regulator makes sure that founders have enough ski in the game. Therefore, by making the founders internalize more costs associated with their decision, they will have better incentives to make more optimal decisions.

Finally, another type of restrictions may consist of imposing caps on the number of votes associated with those shares with superior voting rights. For example, a country may decide, as Hong Kong and Singapore have actually done, to limit the superior voting rights to 10 votes per shares.[109] Thus, they would make sure that, in order to have control, the founders should keep a minimum percentage of the company´s shares capital, and therefore they will likely have more skin in the game.

7. Local factors affecting the desirability of dual-class shares

7.1. Introduction

Many countries and scholars around the world have been discussing whether companies should be allowed to go public with dual-class shares. In my opinion, however, the discussion has not been properly framed. The question is not whether securities regulators should allow companies going public with dual-class shares but whether they should do so –and if so how– taking into account the particular features of a country.

7.2. Sophistication of the market

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[107] This proposal has been suggested in the United States by the Council of Institutional Investors and several authors. See Council of Institutional Investors, *Investors Petition NYSE, NASDAQ To Curb Listings of IPO Dual-Class Share Companies* (24 October 2018) (available at https://www.cii.org/files/issues_and_advocacy/correspondence/FINAL%20Dual%20Class%20Petition%20Press%20Release%20Oct%2024,%202018.pdf); Lucian A. Bebchuk and Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class* Stock, 103 VIRGINIA LAW REVIEW 585 (2017); Robert J. Jackson Jr, *Perpetual Dual-Class Stock: The Case Against Corporate Royalty*, U.S. SECURITIES AND EXCHANGE COMMISSION (2018) (available at https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty).

[108] See Martin Cremers, Beni Lauterbach and Anete Pajuste, *The Life-Cycle of Dual Class Firm Valuation*, ECGI FINANCE WORKING PAPER NO. 550 (2018) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3062895), Robert J. Jackson Jr, *Perpetual Dual-Class Stock: The Case Against Corporate Royalty*, U.S. SECURITIES AND EXCHANGE COMMISSION (2018) (available at https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty).

[109] For a comparison of the requirements to go public with dual-class shares in Hong Kong and Singapore, see CFA Institute, *Dual-class Shares: The Good, the Bad, and the Ugly, A Review of the Debate Surrounding Dual-Class Shares and Their Emergence in Asia Pacific* (2018) pp. 51 (available at https://www.cfainstitute.org/-/media/documents/survey/apac-dual-class-shares-survey-report.ashx).

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One of the most important aspects with considering whether and, if so, under what conditions, companies should be allowed to go public with dual-class shares is the sophistication of the market. In countries with more sophisticated markets (usually formed by more sophisticated investors, investment banks, analysts, proxy advisors, and securities lawyers), the implementation of dual-class share structures will be less risky. In these countries, markets will be able to price –at least much better than in non-sophisticated markets– the value potentially added by the founder.[110] As a result, if the founders realize –usually during conducting the roadshow– that they are not as 'special' as they think they are, they will not have incentives to go public with dual-class shares. Therefore, founders will only choose to go public with dual-class shares if they think – and investors agree- that they can add more value than anybody else.

By contrast, less sophisticated markets are not able to price the quality and skills of the founder in the same way. Therefore, the use of dual-class shares can be riskier in these markets since investors may end up buying shares in companies whose founders and business model is not 'special' at all.

7.3. Legal protection to outside investors

The legal protections available to outside investors are also a crucial factor to consider when deciding how to approach dual-class shares. These legal protections can take many forms though, or they can be found in different pieces of the legislation. For example, the existence of oppression remedies[111], derivative actions[112], minority approvals in related party transactions[113], and minority-appointed directors can be perceived as good practices to enhance the protection of minority investors.[114] Other

[110] These markets will closely reflect the ideas of the Efficient Capital Market Hypothesis in which price reflect all publicly available information and the intrinsic value of the future cash-flows of a firm. See Ronald J. Gilson and Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VIRGINIA LAW REVIEW 549 (1984), Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 THE JOURNAL OF FINANCE 383 (1970).

[111] Tatiana Nenova, *The Value of Corporate Voting Rights and Control: A Cross-Country Analysis*, 68 JOURNAL OF FINANCIAL ECONOMICS 325, 342 (2003) (available at http://schwert.ssb.rochester.edu/f423/jfe03_tn.pdf).

[112] In some countries, derivative actions exist 'on the books' but they are not so common in practice due to a variety of factors, including procedural rules (e.g., distribution of legal fees) and the level of share concentration existing in the country. For an analysis of derivative actions around the world and why they are not common in some countries, see Xiaoning Li, *A Comparative Study of Shareholders' Derivative Actions: England, the US, Germany and China*, (KLUWER LAW INTERNATIONAL, 2007); Arad Reisberg, *Derivative Actions and Corporate* (OXFORD UNIVERSITY PRESS, 2007); Mathias Siems, *Private Enforcement of Directors' Duties: Derivative Actions as a Global Phenomenon*, in Stefan Wrbka, Steven Van Uytsel and Mathias Siems (eds.), *Collective Actions: Enhancing Access to Justice and Reconciling Multilayer Interests?* (CAMBRIDGE UNIVERSITY PRESS, 2012), pp. 93-116; Martin Gelter, *Why do Shareholder Derivative Suits Remain Rare in Continental Europe?*, 37 BROOKLYN JOURNAL OF INTERNATIONAL LAW 843 (2012); Dan W. Puchniak, Harald Baum, and Michael Ewing-Chow (eds.), *The Derivative Action in Asia: A Comparative and Functional* Approach (CAMBRIDGE UNIVERSITY PRESS, 2012); Pearlie Koh, *The Statutory Derivative Action in Singapore: A Critical and Comparative Examination*, 13 BOND LAW REVIEW 64 (2001); Jessica Erickson, *The (Un)Changing Derivative Suit*, in Sean Griffith, Jessica Erickson, Verity Winship, and David Webber (eds.), RESEARCH HANDBOOK ON REPRESENTATIVE SHAREHOLDER LITIGATION (Edward Elgar Publishing, 2018).

[113] Jesse M. Fried, Ehud Kamar and Yishay Yafeh, *The Effect of Minority Veto Rights on Controller Tunnelling*, LAW WORKING PAPER NO. 385 (2018) (available at https://ecgi.global/sites/default/files/working_papers/documents/finalfriedkamaryafeh_0.pdf); Luca Enriques, *Related Party Transactions: Policy Options and Real-World Challenges (With a Critique of the European Commission Proposal)*, 16(1) EUROPEAN BUSINESS ORGANIZATION LAW REVIEW 1-37 (2015).

[114] Massimo Belcredi and Luca Enriques, *Institutional Investor Activism in a Context of Concentrated Ownership and High Private Benefits of Control: The Case of Italy*, in Randall Thomas and Jennifer Hill (eds.), THE RESEARCH HANDBOOK ON SHAREHOLDER POWER (Edward Elgar, 2015); Corrado Malberti and Emiliano Sironi, *The Mandatory Representation of Minority Shareholders on the Board of Directors of Italian Listed Corporations: An Empirical Analysis*, BOCCONI LEGAL STUDIES RESEARCH PAPER NO. 18 (2007) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=965398); Maria Lucia Passador, *List Voting's*

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legal remedies found outside a corporate law or corporate governance framework can include the existence of class actions. Indeed, this procedural remedy can also serve as a powerful tool to protect outside investors, especially in countries with a large market of securities lawyers. In fact, the lack of class actions seemed to be one of the factors influencing the decision to prohibit the use of dual-class shares in Hong Kong.[115]

7.4. Private benefits of control

Closely related to the protection provided to outside investors, another aspect to take into account when analysing the desirability of dual-class shares in a particular country is the level of private benefits of control. In other words, it will be relevant to analyse the level of influence, power and appropriation of corporate resources by insiders. In countries in which controllers enjoy large private benefits of control, as it happens in South Korea, Mexico, Italy or Brazil[116], controllers will be in a better position to extract value from minority investors. Therefore, it will be risker to allow the use of dual-class shares. By contrast, in countries like Sweden, Norway, Singapore, the United Kingdom, and United States, the levels of private benefits of control is very small. Therefore, it will be less risky to allow companies going public with dual-class shares.[117]

7.5. The role of regulators and courts

A good 'law on the books' is usually insufficient unless it is accompanied by a good enforcement. Therefore, the way the law is interpreted and enforced is an essential component of investor protection.[118] Thus, courts and regulators play a very important role complementing the legal protections available to minority investors. In countries with sophisticated courts and securities regulators with the independence, credibility and resources to oversee the market and initiate enforcement actions against any

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Travels: The Importance of Being Independent in the Boardroom, 24 FORDHAM JOURNAL OF CORPORATE AND FINANCIAL LAW 105 (2018); Aurelio Gurrea-Martínez, *Towards a credible system of independent directors in controlled firms*, IBERO-AMERICAN INSTITUTE FOR LAW AND FINANCE, WORKING PAPER SERIES NÚM. 1 (2019 (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3380868).

[115] Hong Kong Exchanges and Clearing Limited, *Concept Paper Weighted Voting Rights* (2014), pp. 20-22 (available at https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2011-to-2015/August-2014-Weighted-Voting-Rights/Consultation-paper/cp2014082.pdf).

[116] Alexander Dyck and Luigi Zingales, *Private Benefits of Control: An International Comparison*, 63 THE JOURNAL OF FINANCE (2004); Tatiana Nevona, *The Value of Corporate Voting Rights and Control: A Cross-Country Analysis*, 68 JOURNAL OF FINANCIAL ECONOMICS 325-351 (2003) (available at http://schwert.ssb.rochester.edu/f423/jfe03_tn.pdf).

[117] In fact, some of them do. For example, 80% of public companies in Sweden have dual-class shares. See report by Shearman & Sterling and ECGI, *One Share One Vote*, ECGI (2007) (available at https://ecgi.global/content/one-share-one-vote-2007). See also Marco Ventoruzzo, *The Disappearing Taboo of Multiple Voting Shares: Regulatory Responses to the Migration of Chrysler-Fiat*, ECGI LAW WORKING PAPER 288 (2015) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2574236). While this percentage can be worrying for other countries, it does not seem to do so for a country like Sweden, not only characterized by low private benefits of control but also – and very related- for their good laws. See Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, ECGI LAW WORKING PAPER 49 (2005) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=784744).

[118] The enforcement of the law is important for the protection of investors. In this regard, potential shareholders and creditors provide finance to firms as their rights are legally protected: Rafael La Porta, Florencio López de Silanes, Andrei Shleifer and Robert W. Vishny, *Investor Protection and Corporate Governance*, 58 JOURNAL OF FINANCIAL ECONOMICS 3 (2000) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=183908). Some authors have even argued that "enforcement of the rule of law is… the central functional difference between developed market economies and developing economies": Erik Bergelöf and Stijin Claessens, *Corporate Governance and Enforcement*, WORLD BANK POLICY RESEARCH WORKING PAPER NO. 3409 (2016) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=625286).

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wrongdoing done by insiders[119], the use of dual-class shares will be less risky. By contrast, in countries with less reliable courts and regulators, minority investors will not enjoy an effective protection in practice. Therefore, the use of dual-class shares will become riskier in these latter jurisdictions.

8. An optimal, tailored response to whether companies should be allowed to go public with dual-class shares

The use of dual-class shares may create several benefits, mainly associated with allowing founders to pursue their (sometimes unique) vision and encouraging firms to go public. However, multiple share structures only entails some risks. While, in my opinion, the costs and benefits of dual-class shares structure are *firm-specific*, regulators should make a choice: how to deal with dual-class shares. For that purpose, it becomes particularly important to analyse the particular features of a country, since the desirability of dual-class shares will differ across jurisdictions, mainly for the costs side of the equation. Indeed, the risks of dual-class shares may increase or decrease significantly depending on the particular features of the country. In countries with sophisticated markets, strong legal protections to minority investors, low private benefits of control, and independent and capable regulators, the use of dual-class shares will not be that risky. Therefore, if a country meets all these features, as it is probably the case of the United States, there seem to be no need to prohibit or even restrict the use of dual-class shares. Companies should be able to choose whether, and if so how, they want to go public. And in case of imposing any restrictions, these restrictions should consist of event-based sunset clauses rather than the mandatory-based sunset clause. These latter provisions should only be considered (if so) if the empirical studies on the long-term value of dual-class shares were conclusive, and taking into account the particular features of each industry. If the results of a particular industry (e.g., non-tech firms) unequivocally shows that the value of dual-class firms decline over time, perhaps a mandatory-based sunset clause can be imposed for firms from that sector. Still, before implementing this policy, the regulator should consider how this policy may affect innovation, IPOs, and the economy as a whole.

By contrast, in countries with non-sophisticated markets, weak legal protections to minority investors, high private benefits of control, and less independent and capable regulators, as it is the case of many emerging economies, dual-class shares should be prohibited or subject to stricter sunset provisions. Moreover, caps on the number of votes per shares and corporate governance reforms to enhance the protection of minority investors should also be implemented. If not, the implementation of dual-class shares could harm, rather than develop, the capital markets, since many outside investors may feel unprotected and they may decide to go somewhere else to invest their savings.

Finally, in jurisdictions with independent and capable regulators, reasonable legal protections to minority investors, and relatively efficient markets, as may be the case in Hong Kong and Singapore, the use of dual-class shares should be allowed subject to minor restrictions. Therefore, the imposition of event-sunset clauses and caps on 10 votes per shares, as both countries actually require, seem a reasonable policy. Likewise, additional corporate governance reforms to provide further protection to

[119] John Armour, Bernard Black, Brian R. Cheffins and Richard Nolan, *Private Enforcement of Corporate Law: An Empirical Comparison of the UK and US*, FINANCE WORKING PAPER NO. 234 (2009) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1105355.); Howell E. Jackson and Mark Roe, *Public and Private Enforcement of Securities Laws: Resource-Based Evidence*, 93 JOURNAL OF FINANCIAL ECONOMICS (2009); HARVARD PUBLIC LAW WORKING PAPER NO. 0-28; HARVARD LAW AND ECONOMICS DISCUSSION PAPER NO. 638 (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1000086).

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minority investors might be desirable, due to the lack of class actions in both jurisdictions, as well as the higher risk of tunnelling existing in both countries as a result of the existence of controlling shareholders.[120]

Moreover, it should be taken into account that the optimal regulatory solution not only will depend on the country but also on the market. For example, in trading venues such as the Catalist in Singapore[121] or the Alternative Investment Market in London[122], where lower listing requirements are imposed and markets do not enjoy the same level of efficiency and liquidity, the use of dual-class shares should be allowed – especially taking into account that these venues are mainly designed for growth companies– subject to higher restrictions. Therefore, Singapore should consider this possible reform.[123] By contrast, in more efficient trading venues such as the Premium Listing in London (where dual-class shares are not allowed) or the Mainboard in Singapore (where dual-class are subject to a variety of conditions), dual-class shares should be allowed with minimum restrictions (e.g., caps on voting rights and event-based sunset clauses).

Finally, it should be kept in mind that some markets might not be developed enough, but they may have an independent, sophisticated regulator. In these cases, if the country decides to allow companies going public with dual-class shares, in addition to other legal reforms, the regulator could also play a major role. Namely, they can analyse, on an individual basis, whether companies have in place enough safeguards. Likewise, they could also find out why the founders want to go public with dual-class shares, and it their argument is based on sound economic reasons. For that purpose, companies can be required to submit a request to the supervisor stating their reasons to go public with dual-class shares. Then, the supervisor would make a decision based on the particular features of the corporation, its business model, the

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[120] For the concept of 'tunneling', see Simon Johnson, Rafael La Porta, Florencio López de Silanes, and Andrei Shleifer, *Tunnelling,* NBER WORKING PAPER NO. 7523 (2000). The authors use the term tunneling *"to refer to the transfer of resources out of a company to its controlling shareholder (who is typically also a top manager".* Therefore, *"it does not cover other agency problems, such as incompetent management, placement of relatives in executive positions, excessive or insufficient investment, or resistance to value-increasing takeovers*". According to the authors *"(….) tunnelling comes in two forms. First, a controlling shareholder can simply transfer resources from the firm for his own benefit through self-dealing transactions. Such transactions include outright theft or fraud, which are illegal everywhere though often go undetected or unpunished, but also asset sales, contracts such as transfer pricing advantageous to the controlling shareholder, excessive executive compensation, loan guarantees, expropriation of corporate opportunities, and so on. Second, the controlling shareholder can increase his share of the firm without transferring any assets through dilutive share issues, minority freeze-outs, insider trading, creeping acquisitions, or other financial transactions that discriminate against minorities (…)".* For other definitions of tunneling, distinguishing between asset tunneling, equity tunneling, and cash-flow tunneling, see Vladimir Atanasov, Bernard Black, and Conrad Ciccotello, *Unbundling and Measuring Tunneling*, 2014 UNIVERSITY OF ILLINOIS LAW REVIEW 1697 (2014). For an empirical investigation of tunneling through related party transactions in Hong Kong and Singapore, see Christopher Chen, Wai Yee Wan, and Wei Zhang, *Board independence as a panacea to tunnelling? An empirical study of related party transactions in Hong Kong and Singapore,* 15 JOURNAL OF EMPIRICAL LEGAL STUDIES 987 (2018).

[121] The Catalist is a platform targeted at young and fast-growing companies. Companies looking to list on the Catalist are subject to less stringent requirements as compared to listing on the Mainboard. See Mak Yuen Teen and Mark Lai, *Catalist: A Platform for Growth Firms or ICU For Mainboard Patients*, BUSINESS TIMES (available at https://www.businesstimes.com.sg/opinion/catalist-a-platform-for-growth-firms-or-icu-for-mainboard-patients). For Catalist Listing Rules, see Singapore Exchange, *Catalist Rules* (available at http://rulebook.sgx.com/en/display/display_viewall.html?rbid=3271&element_id=3176&print=1).

[122] The Alternative Investment Market is targeted at smaller growing companies. See Jonathan R. Hornok, *The Alternative Investment Market: Helping Small Enterprises Grow Public*, 9 THE OHIO STATE ENTREPRENEURIAL BUSINESS LAW JOURNAL 323 (2015) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2476710). See also London Stock Exchange Website (available at https://www.londonstockexchange.com/companies-and-advisors/aim/aim/aim.htm).

[123] Lin Lin, *Venture Capital in Singapore: The Way Forward*, OXFORD BUSINESS LAW BLOG, 19 September 2018 (available at https://www.law.ox.ac.uk/business-law-blog/blog/2018/09/venture-capital-singapore-way-forward).

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founders/managers´ expertise, and the potential risks associated with dual-class share structures (especially in terms of investor protection). Even though supervisors might sometimes fail in their judgment (allowing companies to go public with dual-class shares when they shouldn´t and the other way around), this system would partially supplement what markets do in countries like the United States.

However, for this system to work, three key conditions should be met (i) independence, credibility and expertise of the regulator; (ii) low levels of corruption in the country; and (iii) existence of unsophisticated capital markets. In the absence of these conditions, regulators should not have the discretion to decide whether a company should go public with dual-class shares. For this reason, while the discretion of the regulator may work for countries with low levels of corruption such as Sweden, Norway or Singapore,[124] it would not be recommended for jurisdictions with less credible regulators and public authorities. In Singapore, however, I do not think this discretion is necessary for the Mainboard. In fact, it can even create uncertainty, since founders might not know ex ante what they should prove in order to go public with dual-class shares. Therefore, while I think this discretion would make sense for a less sophisticated market such as the Catalist, this requirement should be abolished in more sophisticated markets. Thus, companies complying with the corporate governance requirements, sunset provisions and listing rules potentially required to go public with dual-class shares should get the approval without further analysis. Even in these cases, I think the decision to go public with or without dual-class shares will not probably be based on the ability of the company to comply with the provisions enacted in the legislation but on success that they may have in the market after getting feedback from investors.

9. Conclusion

Dual-class shares have become one of the most controversial issues in today´s capital markets and corporate governance debates around the world. Namely, it is not clear whether companies should be allowed to go public with dual-class shares and, if so, which restrictions (if any) should be imposed. Three primary regulatory models have been adopted to deal with dual-class shares: (i) prohibitions, existing in countries like the United Kingdom, Germany, Spain, Colombia, or Argentina; (ii) the permissive model adopted in various jurisdictions, including Canada, Sweden, the Netherlands, and particularly the United States; and (iii) the restrictive approach recently implemented in Hong Kong and Singapore. This paper has argued that, despite the global nature of this debate, regulators should be careful when analysing foreign studies and approaches, since the optimal regulatory model to deal with dual-class shares will depend on a variety of local factors. It has been argued that, in countries with sophisticated markets and regulators, strong legal protection to minority investors, and low private benefits of control, regulators should allow companies going public with dual-class shares with no restrictions or minor regulatory intervention (e.g., event-based sunset clauses). By contrast, in countries without sophisticated markets and regulators, high private benefits of control, and weak legal protection to minority investors, dual-class shares should be prohibited or subject to higher restrictions (e.g., time-based sunset clauses and stringent corporate governance rules). Intermediate solutions should be adopted for countries with mixed features. After analysing the theoretical and empirical literature on dual-class shares, as well as the different regulatory approaches adopted across jurisdictions, this article has concluded that there are no single answers and regulatory models to deal with dual-class shares. The 'right' regulatory approach will depend on a variety of local factors. For this reason, the

[124] World Economic Forum, *These are the World's Least – and Most – Corrupt Countries* (2019) (available at https://www.weforum.org/agenda/2019/02/least-corrupt-countries-transparency-international-2018/).

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key question to be addressed from a policy perspective is not whether companies should be allowed to go public with dual-class shares but whether they should be allowed to do so and, if so, under which conditions, taking into account the particular features of a country.

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