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Shopify and the Problem of Shareholder “Approval” at Multi-Class Companies

Media reporting can make proxy season seem more dramatic than it is. While breathless coverage of board strife, impossibly high executive pay figures and shareholder activism at well-known companies is the norm, the overwhelming majority of director election and executive compensation proposals pass with majorities of 90% and upwards.

The handful of proposals that fail understandably draw headlines – yet many proposals opposed by a majority of shareholders fly under the radar. That’s because (with some notable exceptions) most reporting fails to acknowledge how multi-class share structures, which give certain shares typically held by founders and insiders more voting power than those held by institutional and retail investors, obscure investor sentiment.

Proxy voting is highly technical in and of itself, and its ultimate influence on how companies are run is even more complicated. So why does the impact of multi-class share structures matter? Because giving insiders and founders disproportionate voting power often serves to effectively silence ordinary shareholders, threatens the agency and objectivity of the board and removes a key safeguard against excessive pay, related party transactions, and other potential misuses of investor capital.

In this post, we look at how inequitable voting rights influenced 2024 AGM results at Shopify, and at the broader impact of multi-class share structures on the board and its role.

Case Study: Shopify Inc.

Two years ago, Shopify controversially implemented a “founder share” that gave CEO Tobi Lutke 40% voting rights indefinitely, even if his actual economic stake in the company goes down as low as ~2%. A majority of the company’s shares were voted against this arrangement – but because not all of the company’s shares had the same voting power, the founder share was nonetheless granted to Lutke.

At the 2024 AGM, Shopify’s now-cemented triple-class share structure again swung the vote on several proposals. Yet, as in 2022, most media coverage of the general meeting painted an incomplete picture of the results. A Financial Post headline on the day of the meeting read “Shopify shareholders approve executive pay

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plan they were urged to reject" while thelogic.co reported "Shopify shareholders approve executive pay plan, rejecting proxy push." Shopify's subsequent filings announced that all agenda items had been approved.

Like two years ago, the word "approve" is doing a lot of lifting.

According to S&P Capital IQ, institutional investors currently hold 815,336,783 shares in Shopify, or 63.3% of the economic exposure to the company's share price performance. This translates into roughly 40% voting power, equivalent to that of the founder-CEO who only holds 6.2% of company's total outstanding equity.

If the multi-class structure were collapsed and all shares voted on a one-to-one basis, the results indicate that well under half of shareholders supported the pay proposals, with support ranging from 34% for the option plan to 45% for the advisory say on pay. Meanwhile, we calculate that the re-election of director Gail Goodman would only have received 57% support.

Proposal	Votes FOR	Votes AGAINST	Reported % FOR	1:1 % FOR
Elect Gail Goodman	1,254,798,639	389,010,285	76%	57%
Option Plan	1,036,684,888	607,124,037	63%	34%
LTIP	1,068,039,344	575,765,117	64%	37%
Say on Pay	1,137,203,756	506,605,104	69%	45%

Source: Shopify Report of Voting Results for 2024 AGM and Glass Lewis calculations

Impact on the Board

Given that Gail Goodman chairs Shopify's compensation committee, it's likely that shareholder opposition to her re-election stemmed from the same concerns that prompted a majority of them to reject the company's option plan, LTIP and Say on Pay. However, her re-election is notable in and of itself, if only because this outcome was all but assured. For so long as the founder share exists, the election of any Shopify director favored by the CEO is effectively guaranteed, thanks to the effective control that 40% of voting power represents in practice.

This calls attention to the paradox of 'independent' directors on multi-class company boards: though they theoretically represent the interests of all shareholders, in practice only the superior voter can remove them from the board. The board contest that unfolded at Rogers Communications in late 2021, and regressing standards of its board's independence in the years since, serves as a case in point.

The same issues arise at controlled companies with a single share class — but in those cases, where one share equals one vote, the alignment of voting and economic power serves to (somewhat) align the controlling party's interest with that of the company as a whole. By contrast, under a multi-class structure, voting control doesn't require a commensurate level of economic exposure, exacerbating the potential for conflicts between the long-term health of the business and the best interests of the "controlling" party.

Impact on Pay

The impact of this imbalanced power structure on the effectiveness of directors is perhaps most clearly evident in the negotiation of executive pay packages. Independent boards, usually in the form of a compensation or human resources sub-committee, are effectively tasked with negotiating on behalf of the company and its owners opposite the CEO. The board is buying CEO services. It needs to make an offer that the desired executive will accept.

The compensation package typically comprises company cash, stock and perquisites – however, that's not all that's on offer. Beyond their financial remuneration, founders at companies like Shopify enjoy a special relationship with the business, a stature, and an employment arrangement, that they could likely not achieve anywhere else without dedicating years. Theoretically, this unique wad of organizational capital should put the board in a strong position when negotiating CEO services.

However, Shopify's negotiations earlier this year resulted in a new 9-figure grant to the CEO, who already owns over 6% of the business. The compensation committee explained in its 2024 proxy circular that this new mega-grant serves "to empower Mr. Lütke to focus on driving sustained performance" and that the dollar value of the award was reached after "reviewing various factors, including the annual CEO pay level of our compensation comparator group." In making the comparison, the committee does not appear to have even

considered that Mr. Lütke enjoys a far more privileged position than many of the other CEOs in Shopify’s compensation peer group.

Paradoxically, the astronomical incentives offered at Shopify, as well as at other multi-class companies like GFL Environmental (where, after factoring out superior voting shares, the latest say on pay barely received majority support), imply an executive on the verge of being tempted away by better offers – or, more realistically, a captive board that has difficulty pushing back on the CEO or fully representing the interests of other shareholders.

This all raises a worthwhile question of what type of negotiation occurs between an independent compensation committee and a CEO who ultimately has the final say on those same directors’ re-election; a perk which could not be swiftly replicated at any competitor companies.

Impact on Transparency

It’s notable that we had to perform the above calculations to untangle vote results ourselves. Even proponents of multi-class share structures, like the Institute for Governance of Private and Public Organizations (“IGOPP”) in Canada (see “Policy Paper No. 11: The Case for Dual-Class of Shares”, 2019), call for companies to disclose a breakdown of their voting results so that shareholders can more easily isolate the effect of the superior voting shares. The failure to provide such disclosure indicates that companies see value in opacity, and that directors who effectively owe their seat to the grace of the CEO are not in a position to extract even modest concessions.

Aligning Risks & Rewards

At least some of the muffled shareholder opposition to Shopify’s compensation proposals likely reflected the significant level of economic dilution that (most) of the company’s investors are exposed to as a result of equity grants, with the long-term incentive plans allowing for the issuance of up to 31% of issued share capital. Thanks to the founder share, Lutke effectively hasn’t had to absorb the impact of these issuances, since his minimum 40% voting power cannot be reduced by the new equity. This illustrates how “one share one vote” isn’t just a matter of fairness. Equitable voting rights align interests by exposing different parties to the same externalities, supporting the mutual accountability that itself underlies the corporate governance triangle. When certain parties are artificially insulated from certain externalities, such as the dilution that results from new issuances, perverse outcomes can occur.

North American corporate boards are already more insulated than those in other developed capital markets when it comes to the freedom to set executive compensation; like at U.S. listed companies, Canadian say-on-pay proposals are retrospective and advisory. More often than not, the CEO serves as board chair. In spite of relatively weak safeguards, shareholders at companies with ordinary capital structures can – and occasionally do – act as a backstop by coalescing against what they perceive to be problematic governance or excessive pay practices. However, as shown above, at multi-class companies their ability to do so is effectively curtailed.

Conclusion

The retort to one-share, one-vote proponents is often to say that shareholders vote with their feet and could divest if they are unhappy with such a company’s governance or performance. This ignores that many institutional investors and their fiduciaries are invested through passive funds and may therefore not have an active choice, so long as the index does not exclude multi-class companies.

Investors increasingly appear to be taking notice of multi-class share structures, and the need for transparent disclosure. Earlier this year, a proposal calling for Meta Platforms (whose founder maintains majority voting control despite owning less than 15% of the equity) to provide a class-by-class breakdown of its voting results received 17% support – or roughly 45% on a one-to-one basis. Similar proposals have gone to a vote at Bombardier, CGI, Power Corporation of Canada and Alimentation Couche-Tard.

Of course, with company filings and press reporting often failing to acknowledge the existence of these structures, let alone their impact, it’s possible that some shareholders aren’t even aware of the issue.

By Oren Lida | August 7, 2024 | Blog | Comments Off