Some Shareholders are More Equal Than Others

July 23, 2019

Earlier this year, the 166-year-old jeans and apparel company, Levi Strauss & Co. began trading on the New York Stock Exchange, the second time the company entered the public markets in its history. Its shares sold for $17 each, above the proposed asking price of $14 - $16 per share. The company's IPO was filed with a dual-class structure, granting one vote per share for those owning Class A common shares and ten votes per share for those owning Class B common shares. In the case of Levi Strauss, the controlling Haas family, with its ownership of Class B shares, will control 99 percent of the shareholder vote.

Fellow retailers Ralph Lauren Corp. and Under Armour Inc., as well as Internet businesses, Facebook Inc., Alphabet Inc., Snap Inc. and Lyft, also operate under the dual-class structure. In each case, the share structure ensures the company founders have a firm grip of their companies. According to the *Harvard Business Review*, almost 50 percent of recent technology listings have a dual-class status.

The dual-class status has come under some criticism over the past few years by not only shareholders but also by some of the leading institutional investors and global asset managers. For example, the Investor Stewardship Group (ISG), a group that includes financial businesses such as BlackRock Inc., J.P.Morgan Asset Management, Goldman Sachs Management, Miller Howard Investments Inc. and RBC Global Asset Management have either signed off or endorsed the ISG's corporate governance principles.

Of those principles, Principle 2 states that: "Shareholders should be entitled to voting rights in proportion to their economic interest; companies should adopt a one-share, one-vote standard and avoid adopting share structures that create unequal voting rights among their shareholders, and; boards of companies that already have dual or multiple class share structures are expected to review these structures on a regular basis or as company circumstances change, and establish mechanisms to end or phase out controlling structures at the appropriate time, while minimizing costs to shareholders."

The arguments in favor of, or against the dual class structure vary. In the December 2018 issue of the *Harvard Business Review*, authors Vijay Govindarajan (Dartmouth), Shivaram Rajgopal (Columbia Business School), Anup Srivastava (University of Calgary) and Luminita Enache (University of Calgary) point out in *"Should Dual-Class Shares Be Banned?"* that some studies find lower stock returns for dual-class firms as compared to single-class firms, lower trading prices compared to fundamentals, and higher management entrenchment, executive compensation, and value-destroying acquisitions. Other studies, however, show that dual-class structure might be optimal in certain scenarios."

For instance, the authors say, one principal reason for decline in the number of initial public offerings is “the increasing reluctance of technology companies to list their stock, which is largely caused by rising shareholder activism. A ban on dual-class stock would encourage more technology companies to remain private, or motivate listed technology companies to go private, eliminating common investors’ chance to buy even the inferior voting stock. This growing possibility is likely why Hong Kong and Singapore stock exchanges have reversed their earlier stance and allowed dual-class shares.”

Another opinion is that of Commissioner Robert Jackson Jr., appointed last year to the U.S. Securities and Exchange Commission, who says that it is the “perpetual” dual-class structure which should be carefully examined. Jackson Jr. stated in a Columbia Law School blog in January of 2018, that “nearly half of the companies who went public with dual-class over the last 15 years gave corporate insiders outsized voting rights in perpetuity. It raises the prospect that control over our public companies, and ultimately of Main Street’s retirement savings, will be forever held by a small, elite group of corporate insiders—who will pass that power down to their heirs.”

For further reading, click onto the links below:

https://hbr.org/2018/12/should-dual-class-shares-be-banned

http://clsbluesky.law.columbia.edu/2018/02/16/perpetual-dual-class-stock-the-case-against-corporate-royalty/

https://isgframework.org/