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RESEARCH REPORT

WEIGHTED VOTING RIGHTS: ANGEL OR EVIL TO INVESTORS?

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SUMMARY

Stocks with weighted voting rights (WVR) are usually known as dual-class stocks. A company with WVR structure issue at least two classes of shares with different per-share voting rights. While the founders and management usually own one class of shares with multiple votes per share, another class of shares with one vote per share are issued to general investors. New-economy innovative companies tend to adopt WVR structure in their initial public offerings in order to raise funds for business growth while the founders could maintain company control to pursue innovation with disproportionately diluted shareholdings. Mainland China, which is undergoing economic transformation to a new economy, has abundant potential supply of such companies. These WVR companies can choose to list on major overseas markets which accept the listing of WVR companies, such as New York, London, Hong Kong, Singapore and Tokyo.

In Hong Kong, the new listing regime for companies with WVR structure provides a set of safeguards for investors, which are more comprehensive and have even stricter regulatory requirements than other major global financial centres. The investor safeguards offered by the new regime include high entry requirement on market capitalisation, sunset provisions and enhanced corporate governance and disclosure requirements. These measures could not only effectively reduce agency costs, but also limit principal costs. Principal costs matter when investors do not have expertise on innovative sectors (principal competence cost) and when there are potential conflict of interests among investors (principal conflict cost). With appropriate safeguards, a WVR structure for company listing is not necessarily an evil to investors but can be an angel in that it could contribute positively to stock price and operational performance of a company. It is therefore potentially beneficial for long-term value creation.

In fact, international experience demonstrated a number of net benefits of WVR structure to investors for investing in companies with WVR structure. Firstly, the long-run share price returns of innovative companies with WVR structures in MSCI stock indices outperformed other index stocks across different regional and global indices. Secondly, there is no consistent evidence to support the potential adverse impact of WVR structure on companies' business performance; this is also valid in respect of US-listed Chinese companies with WVR structure. Besides, founders of WVR companies are likely to create more firm value as they can implement innovative ideas based on their expertise without much interference from investors. WVR companies could actually broaden investment opportunities to meet the demand of investors with different risk appetites. In this relation, the index company MSCI introduced new index series adjusted for voting rights to cater for investor preferences.

In conclusion, the listing of WVR companies is not a race to bottom, but widens the spectrum of investment opportunities. For an economy, the financial support to WVR companies contributes to its economic transition with new growth engines. For investors, they can choose to invest in trustworthy WVR companies, striking a balance between investment risk and opportunities.

1. AN OVERVIEW OF GLOBAL EXCHANGES IN LISTING WVR COMPANIES

Stocks with weighted voting rights (WVR) are usually known as dual-class stocks. Companies with WVR structure (referred to as "WVR companies" or "dual-class companies") issue at least two classes of shares with different voting rights — "class A" shares with one vote per share and "class B" shares with multiple votes per share. Holders of "class B" shares are insiders or managers of the company, including founders and directors in the management and the voting powers of their unlisted shares are disproportionately higher than their economic interests. This allows the class B shareholders to dominate in the decisions of corporate policies, e.g. nomination of individuals to its board of directors, share issuance and corporate actions[1] without the need to have a proportionately high shareholdings. In contrast, class A shares of the company with one vote per share are listed and are held by external investors. Shares with multiple voting rights are hereinafter referred to as "WVR shares" and shares with one vote per share are hereinafter referred to as "ordinary shares".

While "one-share-one-vote" (OSOV) is the default principle in local company laws of many countries, many stock exchanges provide the flexibility to list dual-class shares under different rules and standards[2]. Many of these exchanges are found in America and Europe but not in Asia until recently, with examples in Brazil, Canada, Denmark, France, Finland, Hong Kong, Italy, Japan, Russia, Singapore, Sweden, Switzerland, the UK and the US[3].

Innovative technology companies are the key contributors to the recent wave of initial public offerings (IPOs) of WVR companies (referred to as "WVR IPOs"). While technology companies have always been active in the IPO market, they increasingly prefer to adopt dual-class structures. Technology and innovative companies have strong funding needs, vis-à-vis traditional companies, to cope with their different term structure of revenues and investments. These companies would have high risks in their investments but would often have high growth potential. Their revenues would be highly volatile in the early stage of operation but the potential long-term growth could be extremely high. The new and innovative technology developments of these companies rely very much on the insights and capabilities of the founders. These companies tend to adopt WVR structure in their IPOs in order to raise funds for business growth while the founders could maintain company control to pursue innovation with disproportionately diluted shareholdings. Reasons for founders of innovative companies to adopt WVR structure may include facilitating the realisation of the company's long-term value, providing the incentives to founders for continuous inputs on innovative capacities and human resources to the company, shielding the threats of hostile takeover bids and protecting the emerging company from institutional investors' possible influence on company decisions with a short-term focus[4].

A listing regime that allows the listing of WVR companies would therefore meet the needs of technology and innovative companies. According to PwC, there were 100 technology IPOs globally raising $25.1 billion in 2017[5]. Another source showed that technology companies in the US accounted for about 36% of all US IPO activities and the share of WVR technology IPOs increased to a record high of 43% in 2017 and eased to 34% in 2018 (see Figure 1).

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1 Corporate actions include dividends, right issues, stock splits, spin-offs and mergers and acquisitions.

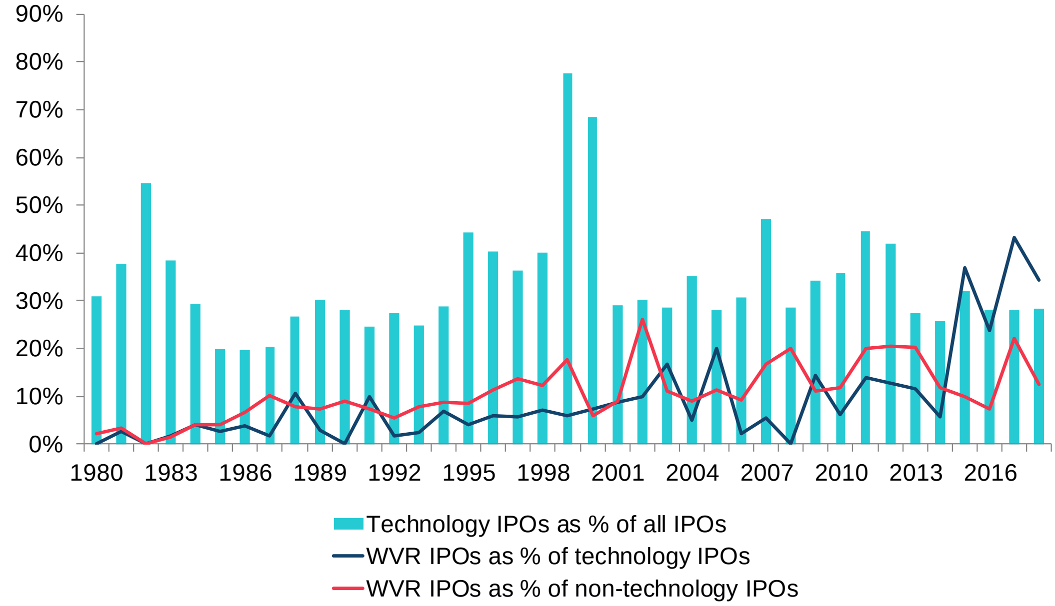
2 See HKEX research report, "Listing regime reforms for dual-class share structure and biotech industry", published on the HKEX website, 24 April 2018.

3 Some of the examples are quoted in Andrea Tan and Benjamin Robertson, "Why investors are fretting over dual-class shares", *Bloomberg QuickTake*, 10 July 2017.

4 See HKEX research report, "Listing regime reforms for dual-class share structure and biotech industry", published on the HKEX website, 24 April 2018.

5 Source: PwC, "Global technology IPO review full-year and Q4 2017", 19 December 2017.

Figure 1. The share of technology IPOs in the US and the share of WVR IPOs (in number terms) in the technology and non-technology sectors (1980 – 2018).



Source: Ritter, J. R., "Initial public offerings: Updated statistics", manuscript, University of Florida, 31 December 2018 (https://site.warrington.ufl.edu/ritter/files/2019/01/IPOs2018Statistics_Dec.pdf).

These WVR technology IPOs include a number of technology giants from the Mainland. To welcome back the listing of these Mainland technology companies, Mainland China is considering ways to accept the listing of new-economy companies with WVR structure. In September 2018, the State Council clarified[6] that overseas-listed new-economy companies that have WVR structures or no profit yet could issue Chinese Depositary Receipt (CDR) in the onshore A-share market. On 5 November 2018, President Xi Jinping announced[7] the plan to launch the Science and Technology Innovation Board on the Shanghai Stock Exchange under a registration-based regime. Based on the trial implementation measures published in March 2019[8], the IPOs of Chinese technology companies and technology companies with WVR structures will be accepted.

Currently, new-economy companies can choose to list in the major global financial centres of New York, London, Hong Kong, Singapore and Tokyo. The evolution of the listing regime for WVR companies varies across these markets. Below is an overview.

(1) New York: The listing of dual-class stocks was once prohibited since 1926 and the New York Stock Exchange (NYSE) officially announced the ban in 1940[9]. In response to competition from other US exchanges, the NYSE proposed in January 1985 to relax the listing policies to allow dual-class structures. In 1994, the US exchanges implemented uniform listing requirements for dual-class stocks. However, from that date onwards, US stock exchanges voluntarily banned US companies from adopting a dual-class share structure after listing ("dual-class recapitalisations") given investors' concern over the potential for existing shareholders to be forced to give up their voting rights. In this

6 *Opinions of the State Council on Promoting the High-Quality Development of Innovation and Entrepreneurship and Creating an Upgraded Version of "Entrepreneurship and Innovation among All the People"* (《國務院關於推動創新創業高質量發展打造「雙創」升級版的意見》), 26 September 2018.

7 See "President Xi's keynote speech at the first China International Import Expo", *Xinhuanet*, 5 November 2018. (http://www.xinhuanet.com/world/ciie2018/jbhkms/index.htm)

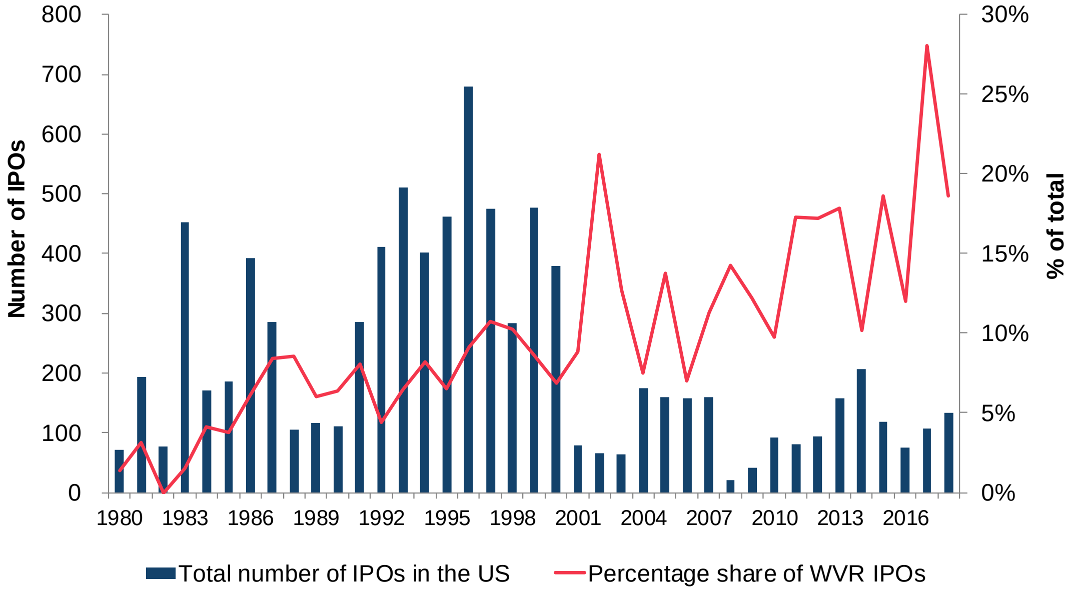
8 *Measures for the Administration of the Registration of IPO Stocks on the Science and Technology Innovation Board (Trial implementation)* (《科創板首次公開發行股票註冊管理辦法(試行)》), issued by the CSRC, 1 March 2019.

9 See Appendix III in the HKEX consultation paper, *Concept Paper on Weighted Voting Rights*, HKEX website, August 2014.

relation, a legal research[10] suggested that dual-class recapitalisations could be beneficial to companies but only in early growth stages.

Currently, the IPOs of WVR companies have become increasingly popular in the US market. Empirical evidence showed that the share of WVR IPOs in the US increased to a record high of 28% in 2017[11] (see Figure 2). These WVR companies might have been attracted by the disclosure-based regime in the US under which companies are only subject to certain disclosure requirements on risk factors of the non-traditional governance structure[12].

Figure 2. Number of IPOs and percentage share of WVR IPOs in the US (1980 – 2018)



Source: Ritter, J. R., "Initial public offerings: Updated statistics", manuscript, University of Florida, 31 December 2018 (https://site.warrington.ufl.edu/ritter/files/2019/01/IPOs2018Statistics_Dec.pdf).

(2) London: The UK market only allows WVR IPOs under the rules of Standard Listing with minimum European Union (EU) requirements. For a listing on the Main board of the London Stock Exchange (LSE), a Standard Listing requires the applicant to meet only the minimum EU harmonisation standards while a Premium Listing requires the applicant to comply with the UK's super-equivalent rules which are stricter than the EU minimum requirements. Premium Listings may contribute to potentially lower cost of capital because of greater transparency. The Premium Listing principles have been tightened since 2014 to follow the proportionality of voting and equity interests[13], i.e. OSOV is required.

Empirical evidence showed that only 5% of listed companies had multiple voting rights in place in the UK market in 2007[14] (see Figure 3). A research paper[15] explained the two

[10] Gilson, R.J. (1987) "Evaluating dual class common stock: The relevance of substitutes", *Virginia Law Review*, Vol. 73, pp.807-844.

[11] Source: Ritter, J. R., "Initial public offerings: Updated statistics", manuscript, University of Florida, 31 December 2018. The dataset used in the research included only the IPOs with offer prices of at least US$5 and excluded American Depositary Receipts (ADRs), unit offers, closed-end funds, real estate investment trusts (REITs), natural resources limited partnerships, small best-effort offers, banks and savings and loans, and stocks not listed on the Center for Research in Security Prices (CRSP).

[12] See Investor Advisory Committee of the US Securities and Exchange Commission (SEC), "Dual class and other entrenching governance structures in public companies", 27 February 2018.

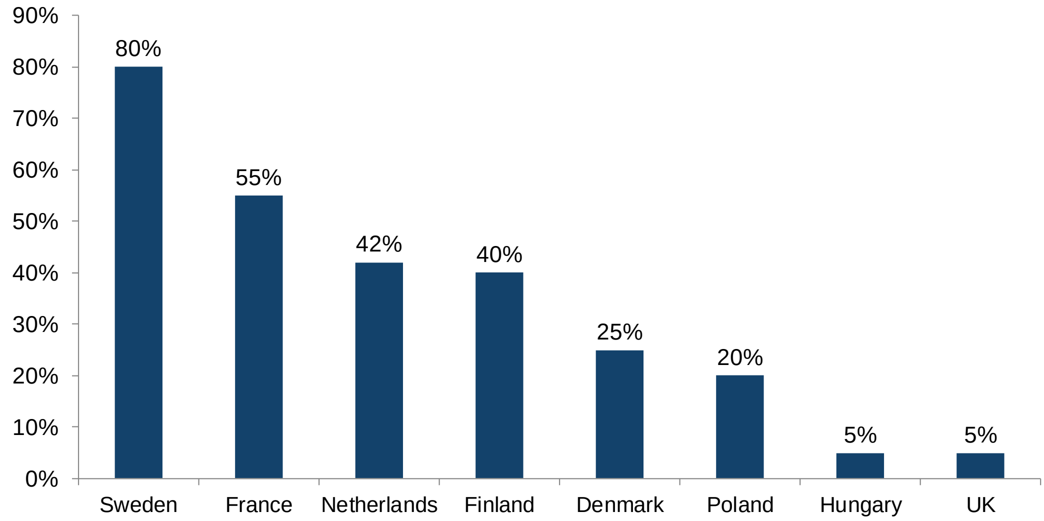
[13] See UK Financial Conduct Authority, "PS14/8: Response to CP13/15 — Enhancing the effectiveness of the listing regime", 3 August 2015.

[14] Source: Shearman & Sterling LLP, *Proportionality between Ownership and Control in EU Listed Companies: Comparative Legal Study — Legal Study for Each Jurisdiction*, external study commissioned by the European Commission, 18 May 2007.

[15] Huang, F. (2017) "Dual class shares around the top global financial centres", *Journal of Business Law*, Vol. 2, pp.137-154.

reasons behind this — the opposition from institutional investors and the elimination of pre-bid defences (e.g. through dual-class structure) in the takeover rules that force to adopt OSOV in case of a takeover bid.

Figure 3. Proportion of companies with WVR structure in Europe (2007)



Source: Shearman & Sterling LLP, *Proportionality between Ownership and Control in EU Listed Companies: Comparative Legal Study — Legal Study for Each Jurisdiction*, external study commissioned by the European Commission, 18 May 2007.

(3) Hong Kong: Hong Kong implemented a listing regime reform in April 2018 with the aim to become a listing hub for innovative companies. The Listing Rules of the Stock Exchange of Hong Kong (SEHK) are revised to allow Main board listing of innovative companies with WVR structures, biotech companies that cannot meet financial eligibility listing requirements and secondary listings of qualified overseas-listed companies. The reform revised the related listing rule (introduced in 1989) to allow deviation from the OSOV principle such that WVR companies may be listed. There were two IPO listings of Mainland technology giants with WVR structure during the first six months after the listing regime reform.

(4) Singapore: The Singapore market extended the acceptance of dual-class structure from newspaper companies to other companies. The Singapore Exchange (SGX) used to ban listings of dual-class stocks except newspaper companies, which are mandated to issue two classes of shares whereby each management shareholder has 200 times the voting rights of an ordinary shareholder under Singapore Newspaper and Printing Presses Act. The Companies Act was amended in October 2014 to allow public companies to issue different classes of shares with either no voting rights or multiple voting rights. The SGX then reformed its listing regime and allow the listing of dual-class stocks from innovative sectors since 26 June 2018.

(5) Tokyo: The Tokyo Stock Exchange (TSE) amended its listing rules in 2008[16] to relax the regulations on accepting WVR IPOs on a case-by-case basis but to continue to ban the issuance of a new share class for existing listed companies. Subsequently, the first WVR IPO on the TSE — Cyberdyne (a wearable robot developer) — was launched in March 2014. After the IPO, the TSE revised its listing rules in July 2014 to impose two additional requirements on the listing of dual-class stocks: (i) necessity and appropriateness for the use of a dual-class structure; and (ii) a sunset clause.

16 See TSE, "Listing system improvement FY2008", TSE website, 27 May 2008.

2. HONG KONG'S NEW LISTING REGIME FOR WVR COMPANIES: APPROPRIATE INVESTOR SAFEGUARDS

Market demand for investing in innovative companies has driven the reform in the Hong Kong market's listing regime to accommodate the listing of ordinary share class of WVR companies (listed share classes of WVR companies are referred to as W-stocks). The Hong Kong Exchanges and Clearing Limited (HKEX) added a new chapter to the Main Board Listing Rules for WVR listings effective from 30 April 2018 after receiving strong support from stakeholders to the proposal in a consultation process. During the consultation process, concerns were expressed about the potential risks associated with investing in companies with WVR structure. The following sub-sections will discuss the concerns and how Hong Kong's new listing regime addresses them through introducing appropriate safeguards.

2.1 Founder manager as the key for success of WVR companies

The founders of innovative companies usually demonstrate that they are the most capable ones to develop and manage their companies. Adoption of the WVR structure is to ensure the absolute control of the company by the founder(s). **The WVR structure can be a double-edged sword and the future of the company will hinge on the founder(s).** If the founder(s) are visionary and consistently making right business decisions, it will be the fortune of the company, the blessing of investors. In this case, WVR preserves the entrepreneurship that supports the share price. On the contrary, if the founder(s) are not capable enough or unfortunately made a mistake, this may be a potential hidden danger for the company and lead to an agency problem.

The "agency problem", or the potential misalignment of interests, between shareholders and managers is the primary concern of investors. It refers to the situation that the shareholders are interested in maximising the share value while the managers who operate the business are interested in maximising their pay and benefits. WVR companies' managers maintain the majority of control with a relatively small share of equity holdings. Other shareholders cannot exert their influence through voting against the managers even if they are not acting for the interests of shareholders. Therefore, proper investor safeguards should be imposed to limit the risk of agency cost for WVR companies. In the absence of appropriate safeguards, the agency problem may hurt investors' interests.

However, the benefits of WVR structure to managers are not necessarily achieved at the expense of investors' interest. On the one hand, investors are exposed to agency costs (or specifically agency conflict costs as explained above). On the other hand, academic literature[17] put forward the principal cost theory to explain how dual-class structure reduces agency competence costs, principal competence costs and principal conflict costs:

- **Agency competence costs:** The cost arising from honest mistakes by management. The magnitude of the costs will vary. If the managers are intelligent, unbiased and informed, they are likely to make relatively few mistakes. For a WVR company, the risk of stepping down is relatively lower for the manager and he/she may be more willing to admit mistakes. These may avoid the risk of hidden mistakes which hurt the long-term growth.

- **Principal competence costs:** The cost arising from investors' mistakes due to the lack of expertise. The cost will be lower if the management (agency) already has the requisite expertise, which will enable the investors (principals) to reap the benefits of specialisation. For a WVR company, the manager usually demonstrates his/her capability to be positive for long-term growth (e.g. track records of successful visionary projects).

[17] Goshen, Z. and R. Squire. (2017) "Principal costs: A new theory for corporate law and governance", *Columbia Law Review*, Vol. 117, pp.767-796.

- **Principal conflict costs:** The costs arising from the conflict of interests among investors. The cost is likely higher when a company has multiple principals (investors) with conflict of interests (e.g. between activist investors with short-term focus and pension funds with long-term focus). For a WVR company, external investors have less impact and the potential conflict among them will be less likely to affect business decisions.

In other words, investors should consider the agency and principal costs together, i.e. total cost of control. Investors can benefit from the WVR structure if the total cost of control is smaller than single share class structure. These rely on whether a listing regime has appropriate safeguards to protect investors from agency costs.

2.2 Institutional investors' call for investor safeguards on WVR structure

Global institutional investors would ask for price discounts of W-stocks in case of the absence of appropriate safeguards. The European Commission conducted a survey[18] of 445 institutional investors worldwide with more than €4.9 trillion of assets under management (AUM) where European investors accounted for 13% of total AUM. 80% of the 445 institutional investors would expect a discount on the share prices of companies with control enhancing mechanisms (CEMs). It noted that there is no safeguard solution for CEMs that fits all, but more transparency on the existence and the impact of CEMs such as dual-class structure is preferred.

It happened in Europe that there was an increasing number of dual-class unifications (conversion of shares with multiple votes into OSOV shares) in early 2000s[19]. The same study also suggested that the dual-class companies should not be forced by law to switch to companies with single-class OSOV shares (referred to as "OSOV companies")[20].

In the US, the Securities and Exchange Commission (SEC) reviewed the listing regime and made recommendations in March 2017 on enhancing the disclosure requirements on dual-class structure and other entrenching governance structures[21]. Besides, the SEC Commissioner Robert Jackson advocated for sunset provisions of perpetual dual-class voting structure in February 2018 while recognising the benefits of these structures[22].

In Canada, the Canadian Coalition for Good Governance (CCGG) [23] admitted that there are advantages and disadvantages for adopting dual-class structures. They note that "it is important to encourage entrepreneurism in Canada and accordingly does not wish to hinder Canadian entrepreneurs from taking their companies public"[24]. As the listing regime and regulations in Canada did not change for more than 20 years, the CCGG published 7 best practices for newly listed dual-class companies in 2013[25], which include the election of

[18] Institutional Shareholder Services, Shearman & Sterling LLP and the European Corporate Governance Institute, *Report on the Proportionality Principle in the European Union*, external study commissioned by the European Commission, 2007.

[19] Pajuste, A.,(2005) "Determinants and consequences of the unification of dual-class shares", *European Central Bank working paper* No. 465, March 2005.

[20] See also Lauterbach, B. and A. Pajuste. (2015) "The long-term valuation effects of voluntary dual class share unifications", *Journal of Corporate Finance*, Vol. 31, pp.171-185.

[21] See Investor Advisory Committee of the US SEC, "Dual class and other entrenching governance structures in public companies", 27 February 2018.

[22] See "Perpetual dual-class stock: The case against corporate royalty", US SEC Commissioner's speech on 15 February 2018.

[23] CCGG is a corporate governance organisation in Canada that is positioned to effect change as the voice of Canadian institutional shareholders.

[24] See CCGG, "Dual class share policy", September 2013.

[25] Ditto.

directors, putting a cap on voting right ratio, coat-tail[26] and sunset provisions, to protect investors' interests.

In Asia, market professionals pursue OSOV principles but ask companies for making adequate disclosure on the WVR structures in case these structures are legal. The CFA Institute[27] conducted a survey of 454 members on dual-class shares in April 2018. The survey results are similar to the CCGG's views in that they recognise both advantages and disadvantages of WVR structures[28]. The recognised advantages of a regime for the listing of dual-class structure companies include boosting attractiveness of the exchange and attracting the listing of companies from technology and other innovative sectors. The identified disadvantages include insufficient minority investor protection and skewed proportionality between ownership and control. **The survey conclusion called for appropriate safeguards**, including mandatory corporate governance measures, time-based sunset, limit on voting right ratio, coat-tail provision and conversion to OSOV shares in case of transfer of shares with multiple voting rights.

2.3 Absence of investor safeguards in the past for WVR structure in Hong Kong

The listing of companies with two share classes is not new to the Hong Kong market. During 1972 to 1973, seven companies issued and listed "B" shares[29] with lower denomination than "A" shares which had the same voting right per share. The underlying objectives were diverse, including fund-raising for the purchase of real estate or for expanding their businesses, and attracting a wider base of investors[30]. While six of them[31] had been either acquired or privatised, there is currently only one company — Swire Pacific — with "B" shares listed in Hong Kong.

At that time, there was no specific chapter in the Listing Rules for this kind of share issuance. At issuance, the company's existing listed shares became "A" shares and the company's "B" shares were offered to existing shareholders[32]. The "B" shares had the same voting rights per share as "A" shares but lower denomination (either one-fifth or one-tenth of "A" shares) and a lower dividend entitlement. A controlling shareholder could spare more cash for takeover defence by selling their stakes in "A" shares and buying the same number of "B" shares to keep the same voting rights at lower prices[33]. In the case of Swire Pacific, each "B" share was issued with a nominal value one-fifth that of each "A" share (HK$0.12 vs HK$0.60) and dividends are paid by reference to these nominal values (even after the abolition of nominal value by law amendment in Hong Kong in 2014). If the control was being challenged, the "B" share would be traded at a premium over "A" shares. However, in absence of competition for control, the Swire Pacific "B" shares had been traded at a lower price, after adjustment for the

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26 Coat-tail provision is a legal provision that allow the subordinate shareholder to participate equally in any formal bid to acquire multiple voting shares.

27 CFA Institute is a global association of investment professionals.

28 See CFA Institute, "Dual class shares and the need for safeguards", April 2018.

29 These "B" shares are different from the usual practice of class B shares with WVR in the US (e.g. class B shares are usually not listed).

30 See Chapter 2 in HKEX consultation paper, *Concept Paper on Weighted Voting Rights*, HKEX website, August 2014.

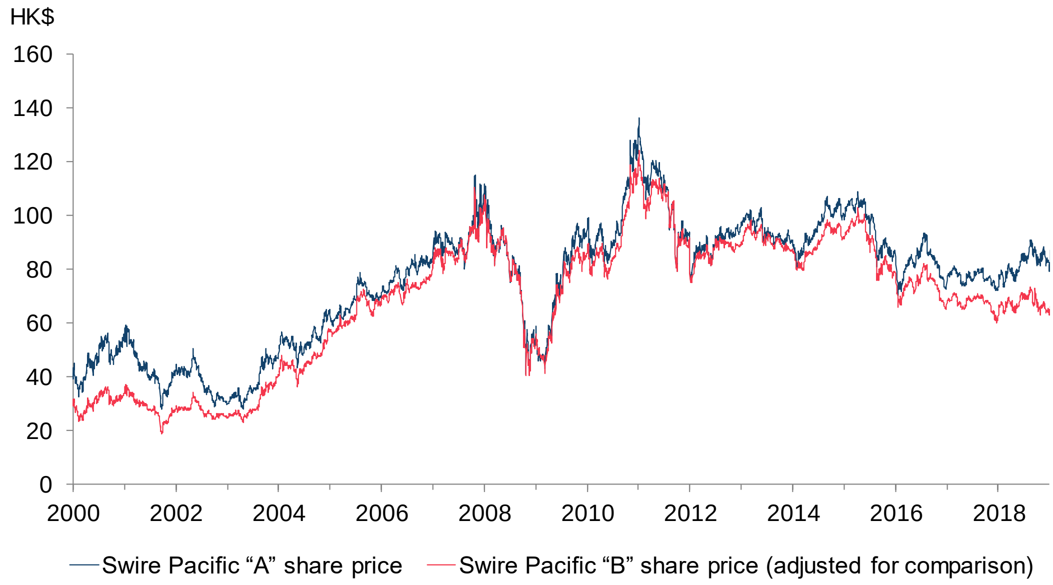
31 These included 5 companies in the Wheelock Marden group — Wheelock Marden and Company Limited, Wheelock Maritime International Limited, Hong Kong Realty and Trust Company Limited, Realty Development Corporation Limited and Lane Crawford Limited. Another company with "B" shares was Local Property and Printing Company Limited. Source: HKEX's *Concept Paper on Weighted Voting Rights*, August 2014.

32 For example, Wheelock redesignated ordinary shares to A shares and issued B shares (1/10 of denomination of A shares) to existing shareholders in 1972 that shareholders could purchase one B share for holding every two A shares. (Source: Fung, B. Y. (2017) *History of Hong Kong Corporate Mergers and Acquisitions (Revised)* (《香港企業併購經典（增訂版）》). Joint Publishing (Hong Kong) Company Limited.

33 See Chapter 26.3 in Chow, M. (2013) *Introduction to Corporate Finance Techniques II* (《財技密碼（下篇）》). Hong Kong Mobile Financial Publication.

degree of dividend entitlement, with an average discount of 12% to the "A" shares during 2000 to 2018 (see Figure 4), due largely to their low liquidity[34].

Figure 4. Price comparison of Swire Pacific "A" shares and "B" shares (Jan 2000 – Dec 2018)



Note: The price of Swire Pacific "B" shares is multiplied by 5 for comparison purpose, as B shares' dividend entitlement is one-fifth that of A shares.

Source: Bloomberg.

In 1987, a number of proposals were made by listed companies on the issuance of such "B" shares but their listings were prohibited by the stock exchange and the then securities regulator on the consideration of strong opposition by both Hong Kong and overseas brokers at that time. A review of the issue on "B" shares commissioned by the government in the same year noted that "there is a legitimate need for their continued availability in exceptional circumstances"[35]. The restriction on the listing of "B" shares was subsequently codified in Rule 8.11 of the Main Board Listing Rules in December 1989. Since then, there had been no new listings of "B" shares.

2.4 Appropriate investor safeguards under the new listing regime for WVR structure in Hong Kong

Hong Kong's new listing regime was designed to achieve a balance between investor protection and benefits to issuers. This gives the flexibility to provide more investment opportunities for investors with different risk appetites and to enable direct financing by innovative companies without diluting the control by their founders. To achieve these, the only way is to introduce appropriate safeguards in the listing regime.

Contrary to the old regime, the listing of WVR stocks in Hong Kong is subject to strict requirements. In the past, there were no specific requirements on the listing of "B" shares. However, under the new listing regime, the chapter for WVR listings in the Main Board Listing Rules of the SEHK imposes a range of safeguards to address investors' potential concerns. These include higher entry requirements for a listing, limits on holdings and voting rights, sunset provisions and conditions on share transfers as well as enhanced corporate governance and disclosure requirements. **In respect of these areas, Hong Kong's new listing regime for WVR companies provides more safeguards compared to exchanges**

[34] Ditto.

[35] Source: Companies Registry, *The Third Interim Report of the Standing Committee on Company Law Reform: B Shares*, July 1987.

in other major global financial centres (see Appendix). The characteristics of these safeguards are discussed below.

The entry requirement on market capitalisation for new WVR listings in Hong Kong is the highest among key global exchanges. The minimum market capitalisation is HK$40 billion (or HK$10 billion with at least HK$1 billion in revenue). High market capitalisation usually means that the company has developed to a reasonable scale and is not a highly risky start-up company. In the global market, the MSCI has included a number of technology giants in its global indices and the ones with dual-class structures usually have much higher market capitalisation than others in the same sector. As of 1 September 2017, MSCI ACWI includes 253 W-stocks and their market capitalisation accounted for 11.2% of the index total[36]. Of these, information technology sector had the largest share of 23.2% of the index's market capitalisation. The average market capitalisation of technology companies with WVR structures was the highest at US$72 billion (compared to the average of US$19 billion for all W-stocks in the index) (see Table 1).

Table 1. Average market capitalisation of W-stocks in MSCI ACWI (as of Sep 2017)

Sector	Number of W-stocks	Total sector market capitalisation (US$ mil)	Average market capitalisation per stock (US$ mil)
Information Technology	24	1,740,097	72,504
Health Care	11	358,682	32,607
Financials	44	722,027	16,410
Consumer Discretionary	61	870,424	14,269
Consumer Staples	29	388,716	13,404
Real Estate	6	70,459	11,743
Industrials	30	306,094	10,203
Telecommunication Services	10	90,228	9,023
Materials	19	136,032	7,160
Energy	10	71,168	7,117
Utilities	9	28,126	3,125
All W-stocks in the MSCI ACWI	**253**	**4,782,053**	**18,901**

Source: Melas, D., "Putting the Spotlight on Spotify: Why have stocks with unequal voting rights outperformed?", posted on MSCI blog, 3 April 2018.

Certain requirements on beneficial holders of WVR shares (referred to as "WVR beneficiaries") are imposed in Hong Kong to limit agency conflict costs. WVR beneficiaries are only limited to natural persons who are directors and materially responsible for the growth of the business. Other requirements on WVR beneficiaries are as follows.

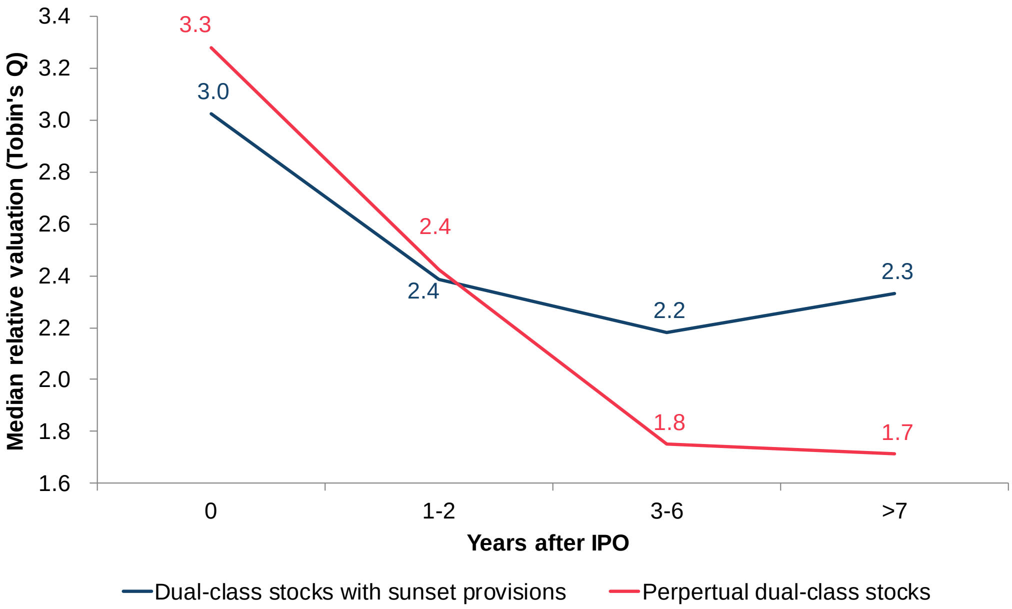
- **Issuance of WVR shares of already-listed companies is not allowed.** After listing, WVR beneficiaries cannot increase the proportion of WVRs. In other words, the voting power of shareholders of ordinary shares (referred to as "non-WVR shareholders") will not be further disproportionately diluted. Non-WVR shareholders must always have at least 10% of total voting rights.
- **WVR shares are subject to a cap on voting right ratio.** The maximum ratio of voting rights between WVR shares and ordinary shares (or maximum voting differential) is 10 to 1 in Hong Kong, which is in line with many markets with dual-class stocks. A historical reason is that the cap for the ratio of 10 to 1 was recommended in the proposal of rules to relax the OSOV principle in 1985 by a subcommittee of the NYSE, although the NYSE did

[36] Source: MSCI, *Should Equity Indexes Include Stocks of Companies with Share Classes having Unequal Voting Rights*, consultation discussion paper for the *Consultation on the Treatment of Unequal Voting Structure*, January 2018.

not adopt any caps on voting differential in the end. An extreme case is the IPO of Snap in the US that only issued non-voting shares to the public in March 2017. In terms of product nature, non-voting shares are similar to fixed-income or other financial products that the return is related to the company's performance but no impact on company decisions[37].

Natural sunset provisions of WVR structure are introduced in Hong Kong to mitigate potential agency conflict costs. The sunset provisions give a reasonable period of time for founders to invest in risky projects for long-term value creation. It is also fair to require conversion of the WVR shares into ordinary shares afterwards. Under Hong Kong's regime, the WVR assigned to the WVR shares is not time-based but subject to a natural sunset clause — WVR will cease when the beneficiary is dead or no longer a director or deemed to be incapacitated for performing duties as a director or to no longer meet the requirements of a director, or upon the transfers of the WVR shares. In other words, their successors cannot inherit the super voting power. While the US market does not require any sunset clause for dual-class structure, the SEC Commissioner Robert Jackson alerted the market for the risk of "perpetual" dual-class stocks. He warned that perpetual dual-class structures will last forever and benefit visionary founders' successors who may not be visionary[38]. He highlighted that the median relative valuation[39] had worsened over time for perpetual dual-class stocks but improved slightly in longer term (7 years or later after IPO) for dual-class stocks with sunset provisions (see Figure 5).

Figure 5. Relative valuation of dual-class companies in the US (IPOs during 2004 – 2018)



Source: "Perpetual dual-class stock: The case against corporate royalty", US SEC Commissioner's speech on 15 February 2018.

WVR companies in Hong Kong are subject to enhanced corporate governance measures which would reduce agency competence costs. The multiple voting rights of WVR beneficiaries in Hong Kong are not applicable for certain resolutions for which OSOV will apply. These resolutions include changes to constitutional documents, appointment and removal of independent non-executive director(s) or auditors, variation of rights attached to any class of shares and voluntary winding-up of the listed issuer. A WVR company is required

[37] Source: CFA Institute, "Dual-class shares: The good, the bad, and the ugly", August 2018.

[38] Source: "Perpetual dual-class stock: The case against corporate royalty", US SEC Commissioner's speech on 15 February 2018.

[39] The firm's "relative valuation" is measured by Tobin's Q ratio. Tobin's Q ratio is the ratio between the market value of a company and the replacement cost of its assets.

to have a corporate governance committee and an ongoing compliance advisor. These safeguards are incorporated into the companies' constitutional documents and WVR beneficiaries are required to provide an undertaking to the company to comply with the safeguards. Similar measures are also introduced in Singapore. In Japan, the articles of incorporation of Cyberdyne (a WVR company) require the conversion of WVR shares to ordinary shares if an offeror holds at least 75% of outstanding shares in a tender offer; that means OSOV will be applied in the case. Similarly, OSOV is applicable for takeover bids with 75% stake of WVR companies in the UK. In contrast, there are no specific enhanced corporate governance measures for WVR companies in the US market currently.

The enhanced disclosure requirements in Hong Kong help protect investors' interests. The new listing regime requires the inclusion of warnings in listing documents and communications that the company is a WVR issuer and that investors should therefore exercise caution when investing. W-stocks are differentiated with a "W" stock name marker. Among the major financial centres, only Hong Kong and Singapore have these unique stock name markers for alerting investors.

In summary, investor safeguards in the Hong Kong market are more comprehensive than those in other major financial centres. These measures would contribute to effectively limiting the total costs of control, including agency costs, for investors while WVR structure reduces principal costs. Under such a regime, investors are likely better protected for investing in stocks with WVR structure in pursuit of potentially promising returns.

3. WVR IS NOT NECESSARILY AN EVIL BUT AN ANGEL TO INVESTORS

Although appropriate safeguards are demanded for better protection of investor interests for investing in WVR companies, this should not be taken as a proof of WVR structure being an evil to investors. In fact, empirical evidence showed that WVR structure can be an angel to investors in that it contributes positively to price and operational performance of a company and is therefore good for long-term value creation. In the light of this, a listing regime with appropriate investor safeguards for WVR companies would enrich investors' choices while keeping investor protection in balance. Detailed discussion are given in sub-sections below.

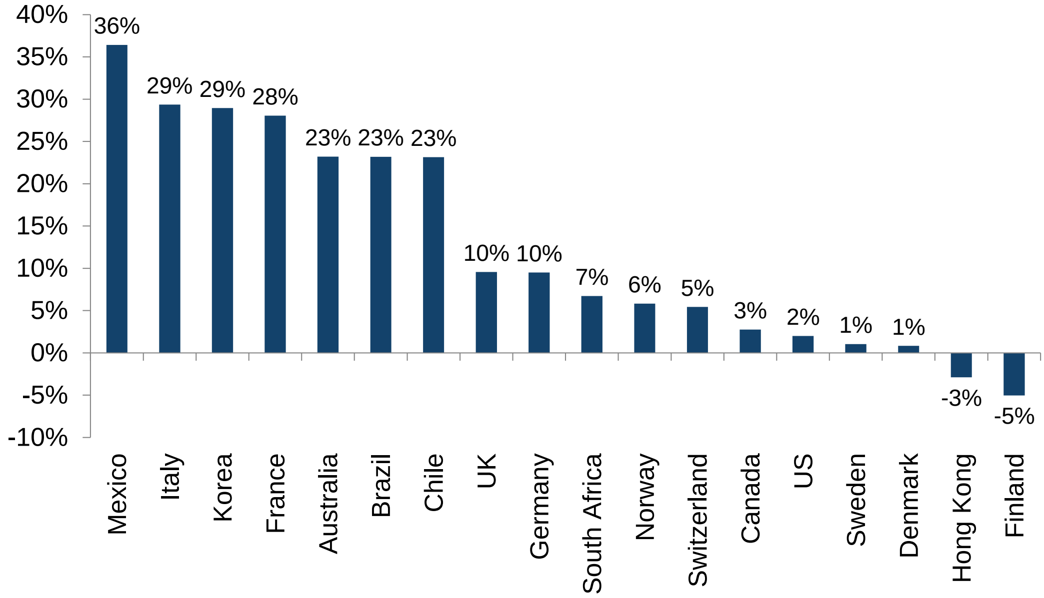
3.1 Discount in prices but potential outperformance in returns

Given the concerns about the potential agency problem of WVR structure, general investors usually ask for a discount in ordinary share prices compared to the share prices of WVR shares to compensate the potential risks of managerial entrenchment and expropriation of firm resources as discussed in section 2. Empirical studies showed that listed shares with inferior voting rights tend to have price discounts. In the US, a study[40] found that the average discount of price-to-earnings ratio (PE ratio) was 17% for the five years following an IPO for 253 dual-class stocks during 1990 to 1998. Another study[41] estimated the value of control worth an average premium of 10%-14% of equity value of the company over the ordinary equity rights for privately negotiated transfers of 393 controlling blocks of shares in 39 countries during 1990 to 2000. A separate study found that the magnitudes of estimated premia for WVR shares relative to their corresponding ordinary shares were different across markets (see Figure 6).

[40] Smart, S., R. Thirumalaib and C. Zutter. (2008) "What's in a vote? The short- and long-run impact of dual-class equity on IPO firm values", *Journal of Accounting and Economics*, Vol. 45, No. 1, pp.94-115.

[41] Dyck, A. and L. Zingales. (2004) "Private benefits of control: An international comparison", *Journal of Finance*, Vol. 59, pp.537-600.

Figure 6. Estimated price premia for WVR shares in different countries (1997)



Note: The price premium was estimated as the value of control-block votes which was calculated from the prices of multiple- and limited-voting shares, adjusted to comprise 50% of the voting power, and scaled by the firm's market value.

Source: Nenova, T. (2003) "The value of corporate voting rights and control", *Journal of Financial Economics*, Vol. 68, pp.325-351.

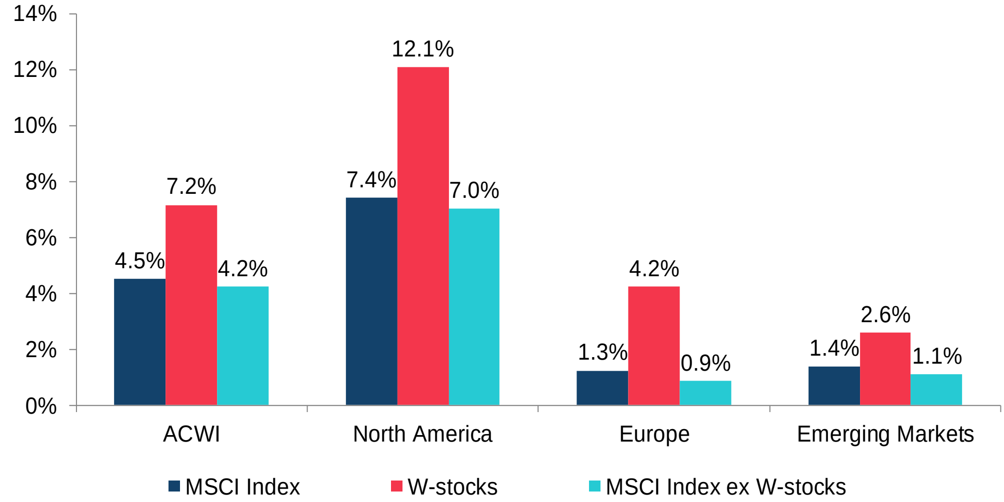
However, a study[42] found that the long-term average return of W-stocks among the MSCI index constituents, in general, outperformed the rest in global and regional markets. As of September 2017, there were 2,493 constituents of MSCI's global benchmark ACWI and 243 of them were W-stocks of WVR companies[43]. During November 2007 to August 2017, the MSCI ACWI's W-stock constituents were found to have an annualised total return of about 7.2%, higher than the 4.5% for the overall index and the about 4.2% for the OSOV constituents. For the MSCI ACWI's regional indices of North America, Europe and Emerging Markets, the W-stock constituents also outperformed the index and OSOV constituents. The degree of active return[44] of W-stocks was found to be different across markets. (See Figure 7.)

[42] Melas, D., "Putting the spotlight on spotify: Why have stocks with unequal voting rights outperformed?", posted on MSCI blog, 3 April 2018.

[43] The MSCI ACWI may include more than one share class of a WVR company, e.g. share class A (OSOV) and share class C (no voting right) of Google's parent company Alphabet are included in the ACWI but not the unlisted share class B which has multiple voting rights.

[44] Active return is defined as the difference in returns between the share price and the benchmark index.

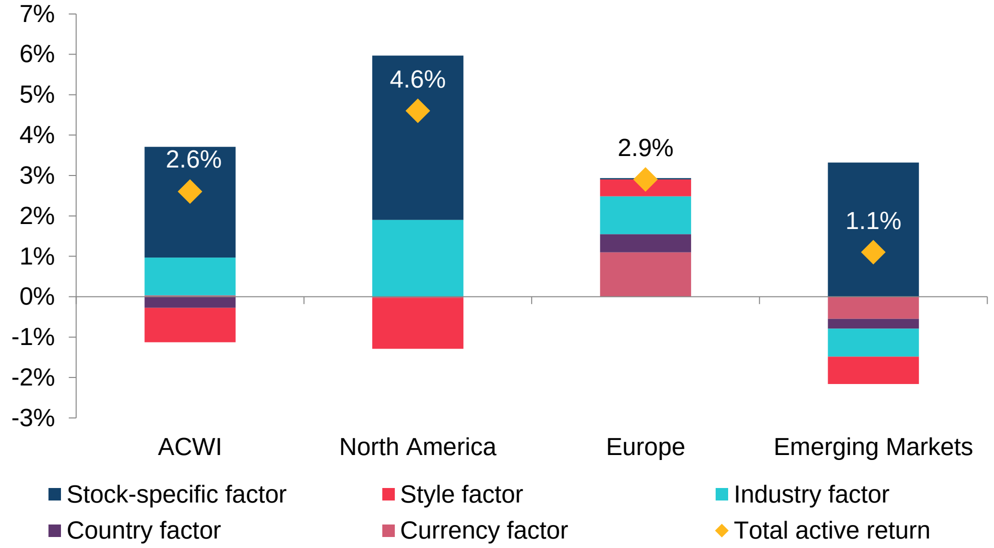
Figure 7. Annualised gross total return of MSCI and W-stock constituents (Nov 2007 – Aug 2017)



Source: Melas, D., "Putting the spotlight on spotify: Why have stocks with unequal voting rights outperformed?", posted on MSCI blog, 3 April 2018.

In the same study, the active returns of W-stocks in MSCI indices were decomposed into returns contributed by different risk factors (see Figure 8). Industry factor gave positive returns (except in MSCI Emerging Markets Index) and this was in line with the strong performance of technology sector in the past decade. The contribution of other key risk factors (e.g. currency, country and market factors) did not give consistent contribution to their outperformance. In contrast, stock-specific risks accounted for a large proportion of active return except in Europe and these may include the founders' innovative visions and their choice of a WVR structure. The same study found that the W-stock constituents possessed the characteristics of relatively large market capitalisation, higher profitability but more volatile, higher asset growth but lower leverage and lower dividend yield, in comparison with OSOV stocks. It supported the assertion that a visionary founder of a company with WVR structure would tend to maximise long-term firm value through investing in risky projects.

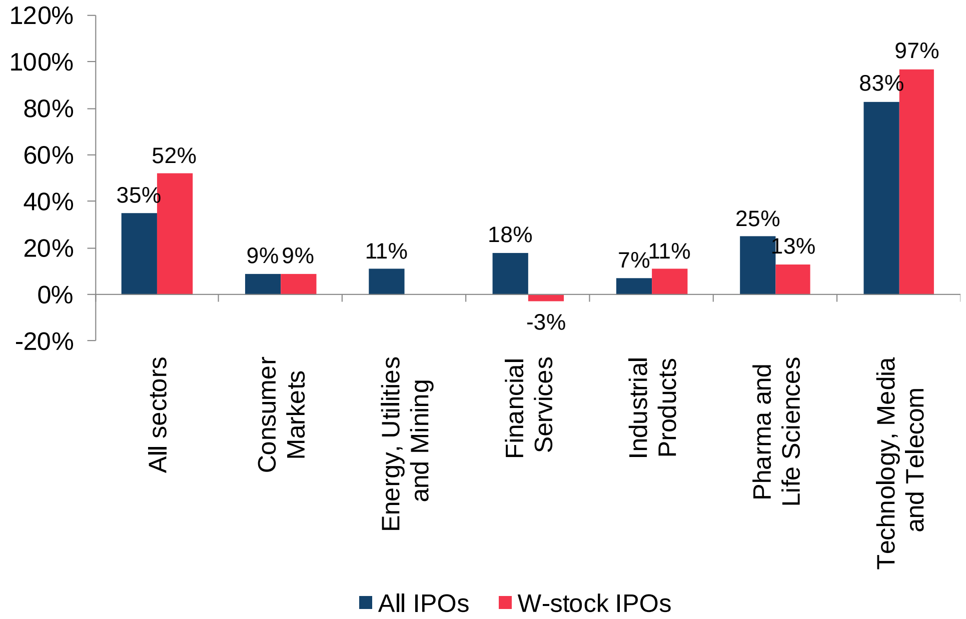
Figure 8. Contribution of risk factors to total active return of W-stocks in MSCI indices (Nov 2007 – Aug 2017)



Source: Melas, D., "Putting the spotlight on spotify: Why have stocks with unequal voting rights outperformed?", posted on MSCI blog, 3 April 2018.

Some empirical studies also found excess returns in W-stocks. A thematic study[45] (referred to as the "D&J Study") looked into dual-class recapitalisation (i.e. an OSOV company became a WVR company by listing a share class of common stocks with limited or no voting rights) of 178 US-listed companies during the period from 1978 to 1998 and estimated the abnormal buy-and-hold price returns to be 5% and 23% in the existing OSOV share class respectively for the first year and the following 4th year after the announcement, compared to the returns of a matched sample without dual-class recapitalisation. Another empirical study[46] found better IPO returns of W-stocks during 2018H1 in the US — during the study period, the average of IPO returns (since the offer date) of W-stocks in the US were higher than those for all IPOs (see Figure 9). For sectoral comparison, the average IPO returns of W-stocks in the technology, media and telecommunication (TMT) sector outperformed the average for all IPOs in the sector; the TMT sector in turn had the highest average return among sectors during 2018H1. This reflects that W-stocks of companies in the innovative technology sector were well received by investors.

Figure 9. Average IPO returns in the US (2018 up to 20 Jun 2018)



Notes: "IPO return" of a stock is the return of the share price of the stock as of 20 June 2018 relative to the offer price. The dataset covers all IPOs in the US (excluding special purpose acquisition companies or SPACs) during 1 January 2018 to 20 June 2018.

Source: Klausner, D., "Dual class IPOs are on the rise: Tech unicorns jump on board this new trend", PricewaterhouseCoopers' Deals Blog, 18 July 2018.

3.2 Indifferent or better business performance for WVR companies

The price discount of W-stocks discussed in Section 3.1 above implies that W-stocks tend to have lower PE ratios relative to their true value and the cost of equity funding through a WVR structure may therefore be affected. This may affect WVR companies' leverage and cost of capital and hence their earnings, thereby impairing investment returns to investors. However, empirical evidence indicated that this might not be the case.

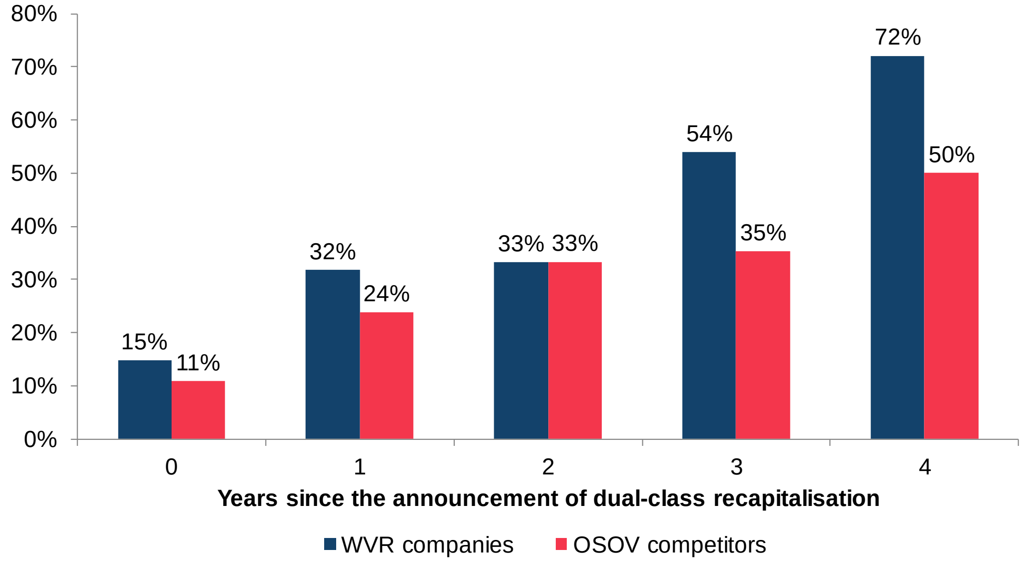
Results of the D&J Study quoted in section 3.1 showed that the income growth and profitability of WVR companies in the US outperformed their non-WVR competitors — WVR companies in the US had higher growth in sales, assets and operating income compared to competitors in

45 Dimitrov, V. and P. C. Jain (2006) "Recapitalisation of one class of common stock into dual-class: Growth and long-run stock returns", *Journal of Corporate Finance*, Vol. 12, pp.342-366.

46 Klausner, D., "Dual class IPOs are on the rise: Tech unicorns jump on board this new trend", PricewaterhouseCoopers' Deals Blog, 18 July 2018.

the same industry with similar size. In particular, the operating income of WVR companies grew by 72% in 4 years' time from the announcement of dual-class recapitalisation, compared to 50% for their competitors (see Figure 10). In respect of profitability, the return on assets was found to be of no difference between WVR companies and their competitors but the return on equity was higher for WVR companies in the first few years following the recapitalisation.

Figure 10. Cumulative growth in operating income of WVR companies and OSOV competitors since the announcement of dual-class recapitalisation



Note: "Year 0" refers to the year when the dual-class recapitalisation was announced.

Source: D&J study.

In Canada, WVR structures were not found to have negative impact on the companies' business performance either. An empirical study[47] examined the impact of WVR structure on profitability (return on assets), firm valuation (Tobin's Q), and takeover premium (cumulative abnormal return) for 10,366 firm-year observations of all Canadian listed companies during the period from 1996 to 2005. In the study, most of the controlling shareholders in Canadian WVR companies were still the founding family members and they still had concentrated ownership in the companies during the study period. Therefore, any expropriation of firm resources would have wealth effect on them too. The study results did not find significant positive or negative impact due to WVR structure.

3.3 Good for value creation

In addition to price discounts and business performance, investors may be concerned about the long-term valuation of WVR companies since the management may not act in line with the investors' interests to create shareholders' value. In fact, some external shareholders (e.g. activist investors) tend to have short-term focus and would like to exert pressure on business decisions of the companies they have invested in. For an OSOV company, activist investors and certain kinds of institutional investors (e.g. hedge funds or other asset managers with short-term focus) can use their votes to alter business decisions to improve short-term share price performance (e.g. high dividend payout instead of re-investment) or to stop investments in risky projects that might create long-term values. On the contrary, for an innovative company with WVR structure, the visionary founders would be subject to less interference in

[47] Jog, V., P. Zhu, S. Dutta. (2010) "Impact of restricted voting share structure on firm value and performance", *Corporate Governance: An International Review*, Vol. 18, pp.415-437.

their pursuit of risky projects in the hope of creating superior long-term value despite possible large fluctuations in short-term returns.

The potential conflict between visionary founders and investors is usually caused by asymmetric information. Investors usually have no expertise about the innovative sector, but the founder generally has better knowledge or an idiosyncratic vision for producing long-term superior returns, which will be shared on a pro rata basis between them and the investors. Therefore, certain long-term investors are willing to invest in WVR companies, with their degree of influence undermined. Although external shareholders have relatively low influence on business decisions of WVR companies, WVR structures of these companies reduce the chance of inappropriate business decisions forced to be made as a result of voting by investors without expertise (principal competence cost).

Some studies did find that the management of WVR companies could create extra value based on their expertise and reduce principal competence cost. One of such studies[48] examined the price premium of OSOV share class in case of takeover. The study worked on a sample of 142 companies with dual-class recapitalisation in the US during 1978 to 1998. Forty-eight of them had significant decreases of insider ownership ("net-sell" companies) through the recapitalisation but insiders still owned about 39% of total shares. These net-sell companies became less risk averse while the ownership became more dispersed. The WVR structure enabled these companies to undertake high risk but value-enhancing projects. In fact, the return on assets of these companies rose significantly as a result of higher capital expenditure and higher leverage. Sixty-seven companies in the full sample of the study were subsequently acquired; among them were companies with both share classes being publicly traded. For these companies with dual-class shares listed, the average takeover premium (defined as the percentage difference between the reported acquisition price and the price four days prior to the announcement) was 53.4% for OSOV share class, which was higher than the 39.7% for WVR share class and the 36.1% for benchmark companies with single share class. The findings undermined the concerns on the potential impact of agency problem on value creation.

WVR structures also avoid principal conflict cost that comes from the potential conflict between long-term and short-term investors. Certain short-term investors (e.g. activist investors) may tend to exercise control over companies they invest in. However, studies found that activist investor behaviours are not always maximising firm value. According to a McKinsey article[49], the number of activist campaigns against US companies increased from 108 in 2010 to 280 in 2016. It highlighted that activist investors in the TMT sector are mostly generalists that have no expertise in these industries. Although activist investors intended to create values, the activist campaigns did not always increase the total returns to shareholders ("total returns" is an overall measure of a company's operating performance, market valuation of stocks, change in stock market expectations about the performance and financial leverage[50]). The total returns to shareholders in excess of that in the corresponding S&P sector index could be positive or negative during the first 3 years after activist campaigns (see Figure 11).

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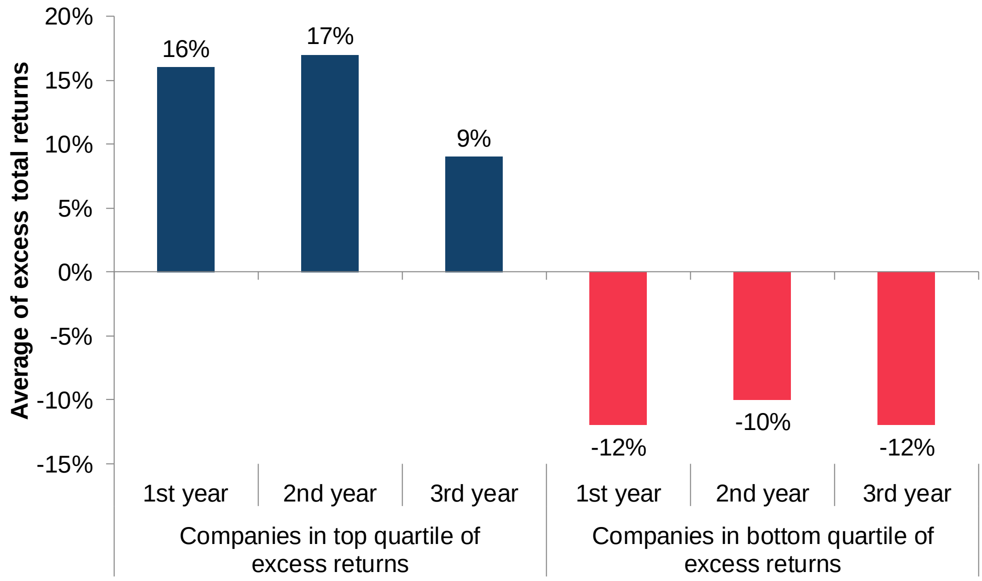
48 Bauguess, S. W., M. B. Slovin and M. E. Sushka. (2012) "Large shareholder diversification, corporate risk taking, and the benefits of changing to differential voting rights", *Journal of Banking and Finance*, Vol. 36, pp.1244-1253.

49 Cyriac, J., S. Otto and D. Wells, "The benefits of thinking like an activist investor", McKinsey website, June 2017.

50 See Deelder, B., M.H. Goedhart and A. Agrawal, "A better way to understand TRS", McKinsey's article on its Strategy and Corporate Finance blog, July 2008.

Figure 11. Excess total returns to shareholders after activist campaigns in the US (2007 – 2017)



Note: The sample comprises 252 unique activist campaigns since 2007 across 151 companies (each with market capitalisation over US$10 billion and revenues over US$1 billion) listed in the US that had the data of 3-year total returns to shareholders available as of 15 March 2017. The excess return of a stock is calculated versus the corresponding S&P sector index.

Source: Cyriac, J., S. Otto and D. Wells, "The benefits of thinking like an activist investor", McKinsey website, June 2017.

3.4 Performance evidence from US-listed Chinese WVR companies

As of end-2018, there were 220 Chinese companies listed on US exchanges, a certain proportion of which were WVR companies. These include 28 companies with IPOs during 2018[51]. Six out of nine IPOs in the first quarter of 2018 (about 67% of the total) came from WVR companies[52]. As quoted in HKEX's concept paper on WVR structure[53] in 2014, about 30% of US-listed Chinese companies had WVR structures; in terms of cumulative amount of IPO funds raised, the share was 48% during January 1998 to May 2014. The paper also noted that 70% of US-listed Chinese WVR companies came from the information technology industry as of May 2014. Another source suggested that the IPOs of US-listed Chinese WVR companies raised US$34 billion during 2007-2017[54], compared to US$442 billion for all IPO funds raised in the US during the same period[55].

Given the possible differences in corporate culture, would Chinese WVR companies exhibit the same or different phenomenon compared to international experiences? Some empirical evidences showed that US-listed Chinese W-stocks did not underperform the stocks of OSOV companies (referred to as "OSOV stocks") in terms of stock price and business performance. A study[56] looked into 33 dual-class and 88 single-class Chinese companies listed on the US exchanges. In respect of price performance, the US-listed Chinese W-stocks performed less poorly in a bear market — the median abnormal return in the second year after IPO was a decline of 13% for W-stocks, compared to the decline of 38% for OSOV stocks (see Figure 12a). The differences in PE ratio and Tobin's Q ratio were not significant between WVR

51 Source: Ritter, J. R., "Initial public offerings: Updated statistics", manuscript, University of Florida, 31 December 2018 (https://site.warrington.ufl.edu/ritter/files/2019/01/IPOs2018Statistics_Dec.pdf).

52 Source: Hu, K., "Chinese companies flooded into the U.S. IPO market in 2018", *Yahoo Finance*, 29 December 2018.

53 HKEX consultation paper, *Concept Paper – Weighted Voting Rights*, HKEX website, August 2014.

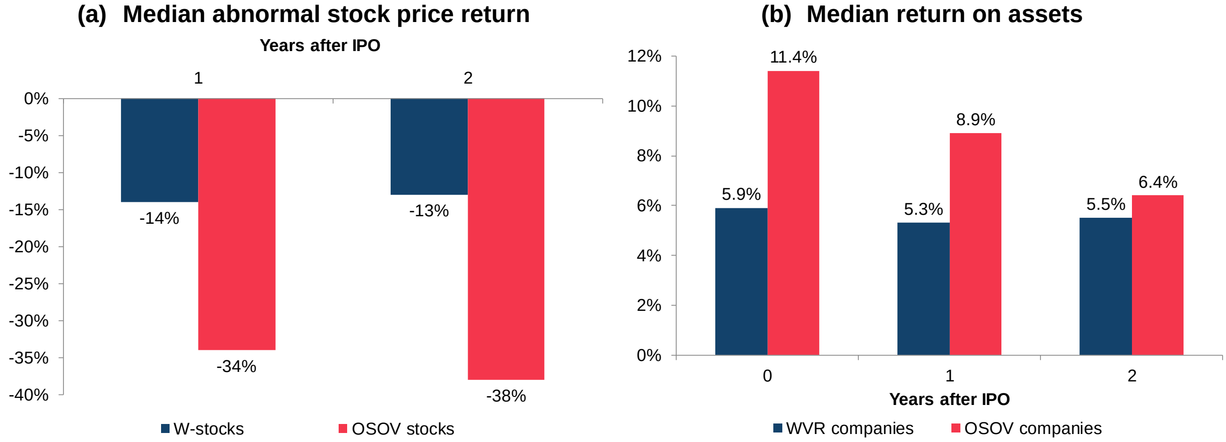
54 Source: Robertson, B. and A. Tan, "Dual-class shares", *Bloomberg website*, 3 May 2018.

55 Source: World Federation of Exchanges.

56 Abdullah, J. Zhou and M. H. Shah. (2017) "Effect of disproportional voting rights on firm's market performance: Evidence from Chinese firms cross-listed on US exchanges", *International Journal of Financial Studies*, Vol. 5, pp.1-11.

companies and OSOV companies. In respect of business performance, the difference in return on assets between WVR companies and OSOV companies was not statistically significant in the second year after IPO (see Figure 12b).

Figure 12. Comparison of stock price and business performances of US-listed Chinese companies (WVR versus OSOV)



Note: Abnormal return is defined as the difference between the actual rate of return in a specific period of time and the market return.

Source: Abdullah, J. Zhou and M. H. Shah. (2017) "Effect of disproportional voting rights on firm's market performance: Evidence from Chinese firms cross-listed on US Exchanges", *International Journal of Financial Studies*, Vol. 5, pp.1-11.

3.5 Broadening the range of investment opportunities

Despite potential concerns of agency problem, WVR companies could be operationally efficient and likely to provide investors with upside potential as discussed above. While certain risk-averse investors may stay away from investments in WVR companies, other investors may be interested in taking the potential upside. The listing of WVR companies helps cater different investors' preferences. Investors interested in new-economy innovative sectors may be willing to take up shares with less voting rights than, but the same cash-flow rights as, the WVR shares. The upside opportunities offered by W-stocks of new-economy innovative companies may be appealing to even the sophisticated investors. An extreme case is the non-voting shares of Snap — the IPO was launched in the US in March 2017 with an oversubscription of more than 10 times[57].

To meet the demand of different investors, the global index provider, MSCI, has resumed the inclusion of W-stocks in its indices. The MSCI once suspended the new additions of W-stocks as the Council of Institutional Investors (CII)[58] advocated for OSOV and pressured index providers to exclude W-stocks after the IPO of Snap's non-voting shares in March 2017. To reconsider the situation, the MSCI held a detailed consultation with market participants on W-stocks. The conclusion of MSCI's consultation was announced in October 2018 that supported the stakeholders to "find the right balance between investor views and comprehensive representation of the investable equity universe"[59]. Pursuant to the consultation conclusion, the MSCI has removed the restriction on new addition of W-stocks into its global benchmark from March 2019, leaving the methodology of existing indices unchanged[60], and launched new index series adjusted for voting rights in March 2019[61]. This

57 Source: Reuters, "Snap tops expectations in pricing of long-awaited IPO", 1 March 2017.

58 CII is an industry organisation of US pension funds.

59 See "MSCI will retain the MSCI Global Investable Market Indexes unchanged and launch a new index series reflecting the preferences of investors on unequal voting structures", MSCI's press statement on 30 October 2018.

60 See "Q&A on the results of the unequal voting structures consultation", MSCI, October 2018.

61 See "MSCI voting rights-adjusted indexes methodology", MSCI, March 2019.

is in line with an SEC Commissioner's comments on the investment value of WVR companies, "if we ban all dual-class companies from our major indices, Main Street investors may lose out on the chance to be a part of the growth of our most innovative companies"[62]. It echoed the case in Canada that the Canadian WVR companies are usually the largest companies and employers in key sectors[63]. Thus, it is hard to exclude them in investment portfolios.

4. CONCLUSION

Global stock markets in major financial centres have undertaken institutional reforms to allow the listing of companies with WVR structures. The main driver is the increasing demand from both the issuer side and the investor side. On the issuer side, visionary founders of innovative companies, including those from Mainland China, tend to prefer going public using a WVR structure to keep a dominating control on business decisions. On the investor side, the upside potential of investment in the new-economy sectors have become increasingly attractive, possibly outweighing the disadvantages of holding shares with inferior voting rights and the risks associated with a WVR structure. Hong Kong is among the major markets in the world that have reformed the listing regime to allow the listing of WVR companies.

Launched in April 2018, Hong Kong's new listing regime includes a more comprehensive range of investor safeguards compared to other major markets. These safeguards could not only effectively reduce the potential agency problem of WVR structure, but also limit the principal costs associated with investors' lack of expertise and the conflict of interests among themselves. The new listing regime is therefore considered beneficial not only to issuers but also to investors.

International experience demonstrated a number of potential net benefits to investors for investing in WVR companies, including possible abnormal price returns and potential long-term value creation. The listing of WVR companies would broaden the spectrum of investment options to meet investors' wide range of needs and preferences. With the potential risks fully assessed, investment in stocks of WVR companies could be an angel to investors.

62 Source: "Perpetual dual-class stock: The case against corporate royalty", the US SEC Commissioner's speech on 15 February 2018.

63 Source: Allarire, Y., "The case for dual class of shares", the Institute for Governance of Private and Public Organisations website, 20 December 2018.

APPENDIX. INVESTOR SAFEGUARDS FOR THE LISTING OF WVR COMPANIES ON EXCHANGES IN MAJOR FINANCIAL CENTRES

Safeguards	NYSE	LSE (under rules for Standard Listings)	TSE	SGX	HKEX
Minimum market capitalisation	US$40 million	£700,000 (~US$540,000)	25 billion yen for 1st section (~US$220 million)	S$300 million (~US$214 million)	HK$40 billion (~US$5.1 billion); or HK$10 billion (~US$1.3 billion) and HK$1 billion (~US$127 million) in revenue
Restriction to new issuers	Yes	No	Yes	No	Yes
Minimum equity threshold held by founders or other WVR beneficiaries as percentage of total issued share capital	No	No	No	None	10%
Maximum voting differentials	No	No	No	Yes (10:1)	Yes (10:1)
Restriction to particular industries	No	No	No	Yes	"Innovative" companies only
Sunset provisions	No	No	Natural sunset provisions	Natural sunset provisions	Natural sunset provisions
Automatic conversion to OSOV shares on retirement / incapacity / death of founder	No	No	Yes	No	Yes
Automatic conversion to OSOV shares on share transfers	No	No	Yes	No	Yes
Enhanced corporate governance measures	No	Yes	Yes	Yes	Yes
Unique stock name marker	No	No	No	Yes	Yes

Source: Exchanges' websites on listing criteria; CFA Institute, "Dual-class shares: The good, the bad, and the ugly", August 2018; and Toshima, K. (2014) "Cyberdyne's dual-class IPO", *International Financial Law Review*, Vol. 33, pp 43-43.

GLOSSARY (AS REFERRED TO IN THIS PAPER)

OSOV	One share with one vote: the OSOV rule (or proportionality principle) refers to equal voting rights for each share, along with the same fraction of cash-flow rights (e.g. dividend entitlement).
OSOV company	One-share-one-vote company: a company with a single class of shares that follows OSOV rule.
OSOV shares/stocks	One-share-one-vote shares/stocks: the share class of a company that follows OSOV rule, while the issuing company may have a single class or multiple classes of shares.
WVR	Weighted voting right: a WVR share structure deviates from the OSOV rule in that a share class has multiple voting rights per share in contrast to OSOV shares.
WVR beneficiary	Weighted voting right beneficiary: the holder of shares with multiple voting rights per share in contrast to OSOV shares.
WVR company	Weighted voting right company: a company with at least two share classes, one of which is the class of WVR shares.
WVR shares	Weighted voting right shares: shares with multiple voting rights per share in contrast to OSOV shares.
W-stocks	The share classes of WVR companies listed on an exchange which are not the WVR shares. In Hong Kong, they are the OSOV shares.

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