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Is Malaysia ready for dual-class shares?

BY **KHAIRANI AFIFI NOORDIN**

Singapore's decision to allow the listing of dual-class shares on its stock exchange has sparked a debate on this side of the Causeway — whether or not Malaysia should follow suit.

The Singapore Exchange (SGX) received the approval of the listing advisory committee on Aug 29, bringing to an end months of heated debate on whether such structures should be allowed. This came about when the Companies Act was amended earlier this year to make it possible for public companies to issue ordinary shares with different voting rights.

According to SGX's annual report, companies would be permitted to have weighted voting rights, subject to various corporate governance safeguards so as to mitigate the inherent risks of such structures. Additionally, dual-class shares would only be permitted if listing applicants have a compelling reason to adopt the structure. Otherwise, the one-share, one-vote structure would remain the default for new listings.

Generally, there are mixed views on the move. One view is that dual-class shares are inherently unfair to minority shareholders while another is that they will add liquidity and vibrancy to the stock market.

Aberdeen Asset Management Asia Ltd, for one, is not so excited about the dual-class shares. Head of corporate governance David Smith says the share structure is unnecessary.

"Rather, they suit companies whose owners want to secure control without commensurate economic interest. We believe this approach is unfair. A company should not be allowed to take outside capital without quid pro quo," he adds.

"If Singapore, or rather SGX, believes it can jump into the breach, it will forfeit its reputation for transparency. That reputation has been hard won. It would be a pity to jeopardise it for short-term gain in the form of fees and the potential prestige of new listings."

A dual-class share structure is defined as the issuance of various types of shares by a single company. The different classes have varying voting rights, dividend payments and other characteristics. Typically, one class of shares (with limited voting rights) is offered to the general public while the other class (with more voting power and often provides majority control of the company) is offered to company founders, executives and family members.

In the US, both the Nasdaq and New York Stock Exchange (NYSE) allow companies with dual-class shares to list. Tech companies such as Facebook, Google and LinkedIn offer different classes of shares. Non-tech companies such as Berkshire Hathaway and Ford have also adopted the structure.

In Asia, however, the structure is fairly new. In 2014, Hong Kong Exchanges and Clearing Ltd scrapped the dual-class shares proposal after seeing opposition from the regulator, the Securities and Futures Commission. Because of this, Hong Kong lost e-commerce giant Alibaba's record-breaking US$25 billion listing to the NYSE.

THE MALAYSIAN PERSPECTIVE

The decision by SGX to allow companies to list dual-class shares has revived the old debate — is it good or bad, and should Malaysia adopt the practice? Is Bursa Malaysia ready, and how will it benefit retail investors?

Dual-class shares may give rise to potential abuse by the class with more power, says Rita Benoy Bushon, CEO of Minority Shareholder Watchdog Group (MSWG). "These could include non-merit-based senior appointments, centralised decision-making with little recourse for minority shareholders (they could be the majority) in cases of losses as well as other risks of mismanagement by these insiders."

She also says the structure creates an unfair playing field comprising the "founders" class of minority shareholders and another class of minority shareholders, which normally consists of retail and institutional investors. She is also concerned that the structure may lead to a lack of protection for minority shareholders.

"In a market such as Malaysia, the proper recourse against abusive insiders, such as class actions and other infrastructure support, is not facilitative. The protection of minorities would then fall on the regulators. This compares with the more developed countries, such as the US, where there is an existing sophisticated investor community and a good legislative framework to provide minority shareholders with robust protection," says Rita.

Chow Kar Tzen, senior portfolio manager at Affin Hwang Asset Management Bhd, sees the positive side of dual-class shares from a capital market standpoint. He says the share structure may have a positive impact as there could be more listings on the local bourse. This would lead to a larger and more vibrant stock market.

"We will have more companies, more liquidity, more choices and a more vibrant market. When more attractive companies list on the stock exchange, the market capitalisation will go up. Your weighting on the MSCI indices, for example, will go up. More emphasis or weighting is given to countries with bigger markets, so that is a benefit," he adds.

"The companies that are currently practising this, such as Berkshire Hathaway and Google, are really good listings that investors like. If these kinds of companies are listed here in Asia — whether in Singapore or Malaysia — it is very good for investors."

However, Aberdeen Asset Management's Smith says this is not the case. He points out that from Singapore's perspective, complaints that the market needs "boosting" are usually made by disgruntled investors and companies that believe their shares are worth more than they are.

"Market operators may believe that by attracting new listings they will create interest that will benefit the market as a whole. But while liquidity may help in the short term, the long-term reasons for poor market performance are usually structural and fundamental. If there are too many listed companies with small free floats, which are not well covered by researchers and which lack transparency, investors will be put off," he says.

Danny Wong, CEO of Areca Capital Sdn Bhd, says there will always be two points of view when it comes to dual-class shares, and good or bad will depend on the camp you are in. However, he believes that if it is implemented by the authorities, it will improve the market environment.

"Every time there is a new structure, it is for the betterment of the exchange. So, we have to move forward," he adds.

As an aside, Bursa already has different classes of shares — restricted and preference. Restricted shares are usually held by foreign investors when their shareholding exceeds the foreign ownership cap. The holders of these shares do not have voting rights.

Dual-class shares are especially attractive to tech companies, say market observers. That is because the structure allows companies to innovate without the risk of short-term-oriented shareholders forcing the founders or entrepreneurs to change course.

As the structure allows the economic interests of external shareholders and internal management to be more aligned, it is able to attract more entrepreneurially run companies to list in the country, says Chow.

"From these companies' standpoint, dual-class shares are beneficial because even though the shareholding is diluted, the entrepreneurs are still able to maintain control of the company. However, the risk is when the entrepreneurs themselves have corporate governance issues. Therefore, it boils down to integrity as well."

MARKET READINESS

At the time of writing, there have yet to be any companies expressing interest to list on SGX with dual-class shares. Aberdeen Asset Management's Smith says the fund house has no idea how companies with the structure will perform.

"They might be shunned by institutions like us who find dual-class shares discriminatory. Equally, retail investors might welcome the opportunity to invest in new listings if they were a consequence, especially if these listings included popular names," he says.

While it is not clear how Malaysia will benefit from dual-class shares and the risks that come with them, the question is whether it is ready to adopt the structure.

Chow says the public should have more knowledge of the potential impact of the structure before introducing it here. "There needs to be more education on how it works, the potential pitfalls and risks involved. Additionally, the authorities should implement extra safeguards to avoid issues such as abuse of minority shareholders. They must think of a way to protect the investors' rights."

Rita concurs, saying that infrastructure support, including legislation and investor education, should be put in place in addition to having specific parameters with full disclosure and transparency for investors. "As MSWG supports the one-share, one-vote principle, the organisation is not in favour of allowing the dual-class structure. However, to handle the dichotomy between founder-based entrepreneurial companies and the protection of minority shareholders, policymakers could look into having some kind of mechanism to address these issues — perhaps by having another exchange or a sub-category on the main exchange to cater for such companies.

"Such dual-class share structures could be permitted for a number of years, giving time to the founders to grow their companies and to transition out of the dual-class shares to ordinary shares. Regulators would then need to have stronger oversight for investors' protection in such a class."

Chow says even though the structure is able to boost the local capital market, from a size standpoint, the regulators should consider that allowing it in Malaysia does not necessarily mean the market will be able to attract companies that are issuing dual-class shares, such as Facebook, Google and Alibaba, to list on the local stock exchange because, among other things, the stock market is still small.

Dual-class share listings aside, Wong says regulators should open up markets because of globalisation. "If we are not ready, then the regulators must come up with a blueprint to help us prepare for that."

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