

# The DCS Forum: Dualing Over Governance, Risks and Rewards

On 28 February 2017, some 100 SID members and guests turned up to debate the SGX Consultation Paper, “Possible Listing Framework for Dual-Class Share Structures” that was issued on 16 February 2017. There was little sitting on the fence as speakers and participants provided strong and passionate feedback on the benefits, governance issues and alternative approaches.

In welcoming participants to the dual-class shares (DCS) forum, Joyce Koh, Executive Director of SID said SID will take into account the views from the session in formulating its response to the Consultation Paper.

The forum began with two presentations. The first was by Mr Tan Boon Gin, Chief Regulatory Officer of SGX, who provided a gist of the SGX Consultation Paper and the feedback the Exchange was seeking. The second was by Mr Ng Wai King, Managing Partner of WongPartnership who gave an overview of DCS structures in other jurisdictions and the key issues and challenges encountered.

A diverse panel then took to the stage. Moderated by Mr Lee Kim Shin (Managing Partner of Allen

& Gledhill LLP), the panel included Mr Ng; an independent director, Mr Soh Gim Teik, Vice-Chairman of SID; an institutional investor, Dr. David Smith, Head of Corporate Governance at Aberdeen Asset Management Asia; and a venture capitalist, Dr. Jeffrey Chi, Chairman of the Singapore Venture Capital Association.

A lively discussion ensued among the panel members, as well as with participants as all took the opportunity to share their candid views on the pros and cons of DCS and even alternative structures.

A summary of the key points from the speakers and participants are covered in the next four pages.



# Regulatory Considerations for DCS Structures



Mr Tan Boon Gin

## Consultation Paper seeks feedback on:

- Should the DCS Framework be introduced?
- What safeguards against key risks may be?

## Key principles

- If DCS is introduced, the one-share one-vote structure will remain the default structure for listed companies.
- DCS will only be allowed for IPOs.
- Possible safeguards are focused on mitigation of entrenchment and expropriation risks.

## Key risks of DCS structures

- **Entrenchment risks:** Owner-managers become entrenched in management of the company to the detriment of non-controlling shareholders.
- **Expropriation risks:** Owner-managers seek to extract excessive private benefits from the company, to the detriment of non-controlling shareholders.

## Raising investor awareness (if DCS is introduced)

- **Clear disclosures**
  - > Clearly identify DCS companies in SGX data disseminated for display.
  - > List all MV shareholders in annual reports.
- **Investor awareness**
  - > Investor education.
  - > Risk disclosures in prospectus.

## Possible Safeguards for Entrenchment Risks

- **Limit Voting Differential.** Each MV share carries up to 10 votes, while each OV share carries one vote.
- **Restrict Share Issue.** Issuers are prohibited from issuing MV shares post-listing except in the event of a rights issue.
- **Automatic Conversion.** MV shares are automatically converted into OV shares upon sale or transfer; or cessation of service.
- **Sunset Clause.** DCS structure is converted into single class at a future date or upon specified events.

## Possible Safeguards for Expropriation Risks

- **Board with more IDs.** The majority of the board and board committees (NC, RC, AC) including their chairmen, to be independent.
- **Equal votes for IDs.** Each share gets one vote in voting for independent directors.
- **Risk Committee.** A separate risk committee established to oversee risk management.
- **Coat-tail Provision.** All shareholders must be allowed to participate in takeover offer at the same price.



# The DCS Landscape



Mr Ng Wai King

## Characteristics of DCS structures

- Two separations
  - > Separation of voting power from equity.
  - > Separation of voting power from economic rights.
- Usually achieved by:
  - > Having a class of shares with additional voting rights (e.g. super-voting shares which have 10 votes per share instead of one vote per share); or
  - > Granting a particular class of shares or a group differentiated voting rights (e.g. the right to appoint a majority of the board).
- US examples: Alibaba, Facebook, Google.

## Why DCS structures?

- Allows a founder/owner to maintain control of a company (i.e. voting power) and also enables them to access the capital markets at the same time.
- Industry-specific reasons e.g. Media (protect editorial integrity), Fashion (brand image with founder); Technology (long-term innovation without short-term pressures).

## DCS in other jurisdictions

Jurisdiction	DCS Structure	Listing
US	Yes	Yes
Canada	Yes	Yes
Hong Kong	Yes	No
UK	Yes	No, except for secondary listings
Sweden	Yes	Yes
Australia	Yes	No

## Governance issues

- Entrenchment and expropriation risks
  - > Not unique to DCS.
  - > DCS is a “leveraged play on the management”, i.e. amplifies the success or failure of management.
- Measures to mitigate risks
  - > Improving corporate governance framework.
  - > Imposing fiduciary duties on controlling shareholders.
  - > Minority actions.
  - > Enhancing independence element on the board and voting process for IDs.
  - > Risk committees.

## Takeover issues

- Takeover Code principles
  - > Typically premised on “one share, one vote” rule.
  - > Primary objective is “fair and equal treatment of all shareholders in a takeover or merger situation”.
  - > Compliance rests with parties to a takeover or merger (including directors).
- Takeovers in DCS situation
  - > A DCS structure is an anti-takeover measure.
  - > Directors generally cannot frustrate a takeover offer.
  - > Public shareholders in DCS structure must accept that no takeover offer can occur unless the MV shareholders are prepared to give up control.
  - > Question arises of when control passes if there is an automatic conversion.
- SGX coat-tail provision
  - > SGX is proposing a coat-tail agreement among MV shareholders, issuer and a trustee.
  - > Such an agreement will prevent transactions that otherwise would deprive the OV shareholders of rights under the Takeover Code.
  - > MV shareholders will be obliged not to sell unless concurrent offer is made to OV shareholders.

# Panel Discussion: To Dual or Not To Dual?

## Why it is needed

“Venture-backed companies are typically not majority controlled by their founders by the time they are mature enough for a public listing. Allowing a DCS structure would provide the founders to have a stronger footing in continuing to realise their vision for their company benefitting all shareholders.”

**Dr Jeffrey Chi**

Chairman, Singapore Venture Capital Association

“DCS addresses the needs of certain founders (whose brand, technology or business model is closely associated with them); the challenge for the investing community is to accept the limitations of the DCS when it comes to voting.”

**Mr Ng Wai King**

Managing Partner, WongPartnership

## Why it may work

“Directors used to the one-share one-vote system can see DCS as undemocratic. But they can reset their thinking and rise up to DCS structures. The bar needs to be raised and we need to be innovative. An independent board is a must for good corporate governance. MV controlling shareholders should preferably not be allowed to vote on the appointment of independent directors.”

**Mr Soh Gim Teik**

Independent director, and Vice-Chairman, SID

“A good founder is key to the DCS structure, but it is probably more important to have a good management team to support the founder in order to move things forward. The focus of the listing criteria should be on a strong management team. We also need the regulatory bodies to take the lead and act against errant founders/companies. As Singapore is not a litigious society, the regulatory bodies should be more vigilant in enforcing the rules.”

**Mr Ng Wai King**

“Everyone has an opinion on DCS. It is clear that the debate will go on for some time but it is important that all stakeholders give their views via the SGX Consultation Paper. At the end of the day, we need to move forward and I am sure we will find a good balance for all stakeholders to make Singapore a vibrant market.”

**Mr Lee Kim Shin**

Managing Partner, Allen & Gledhill LLP

## Why it is not needed

“Long-term investors are not queuing up to throw out visionary founders before profit starts kicking in. They are usually patient but there could be some short-term noise from short-term investors, which is not unusual in a dynamic market. Amazon is a good example of a company where investors have been patient with a founder investing for the long term.”

The DCS Consultation Paper itself acknowledges that DCS can lead to ‘lower efficiency in the use of cash resources by a company, and less successful acquisitions and returns on capital expenditure’. On the other hand, technology companies like Apple, Microsoft and Amazon are very successful despite having only single class shares.

In Singapore, shareholders should be asking for more rights to hold boards to account to improve corporate performance, not acquiescing to less. This would, I believe, create a more vibrant capital market rather than introducing DCS to achieve the goal.”

**Dr David Smith**

Head of Corporate Governance, Aberdeen Asset Management

## Why it may not work

“There are two aspects of the proposal that may not work. First, the criteria of \$500 million will be a huge barrier. Second, the sunset clause will discourage entrepreneurs.”

**Mr Soh Gim Teik**

“The devil is in the details. While safeguards are necessary to protect investors, too much safeguards may negate the benefits of DCS structures, so is it worth it? The sunset clause is not easy to implement, as therein lies the judgement call to decide on the appropriate timeframe.”

**Dr Jeffrey Chi**



L to R: Mr Lee Kim Shin, Mr Soh Gim Teik, Dr David Smith, Dr Jeffrey Chi, Mr Ng Wai King.

## Impact on Singapore CG scores and rankings

“Singapore has scored well in the last three ACGA biennial CG Watch but it has been conveyed to us that adopting the DCS will adversely affect our future scores.”

**Mr John Lim**  
Chairman, Boustead Projects

“The ACGA rankings show that we score well in comparison regionally, but we may not be that good internationally. We should hold out to higher standards, perhaps consider making the Code of Corporate Governance compulsory for all companies, perhaps emulate the UK standards.”

**Mr Christopher Leahy**  
Founder, Blackpeak Group

“If Singapore adopts DCS, so might other countries around the region. It is the contagion effect. So, while Singapore will see its governance scores drop with DCS, all will be balanced out, as all will similarly drop if they were to adopt DCS. But that is not the point. We should be innovative and give more rights to all shareholders, not favour the few.”

**Dr David Smith**

## Create a regulatory sandbox

“Singapore always has an instinct to be bold in its initiatives but once it declares the initiative, it tends to take half steps back and start hedging by creating a lot of protection around it. We need to make a bold statement and try it out as there are enough judicial infrastructure to handle any fallouts as we have done in the past. The current initiative is a narrow one and maybe, the way forward is by having a sandbox for these high technology companies. If they are ready and want to be on the mainboard or catalyst, then they should comply with existing rules and hence there is no necessity to have extra clauses. There is no need to protect the founders as they are not “blushing brides” and they know how to protect themselves. If the market does not value them, there are people who would be happy to sign a cheque.”

**Mr Quek Peck Lim**  
Chairman, PrimePartners

## Go further to a free-for-all market?

“The regulators should take a more liberal approach. It can be more innovative. There can be multiple classes of shares, and no limit on number of votes for any class. The disclosures under the current Code of Corporate Governance are too stringent and should be relaxed. At the same time, lower the barrier for ordinary shareholders to take class action suits.”

**Mr Henry Wang Xinbin**  
Executive Director, Everbright Business Consultancy

“While the US has class action suits and contingency fees, we should consider whether we want a more litigious system. Despite such strong checks and balances, companies are still going to the US to list so it is all about striking the right equilibrium. Companies will look at the ecosystem in totality and our way of striking that equilibrium is through safeguards that give shareholders an equal voice in key governance matters.”

**Mr Tan Boon Gin**