

Dual-class share structures: what pension schemes should know

With recent and anticipated initial public offering (IPO) activity from SpaceX, Anthropic and OpenAI, dual-class share structures are in the spotlight as a potential governance risk. Below, we explain what dual-class share structures are, why they create governance and stewardship hurdles for investors, and how pension schemes can adequately address these challenges.

What are they?

A dual-class share structure gives different voting rights to different classes of shares. Founders, directors or early investors typically hold shares with enhanced voting rights compared to those held by public market investors. This allows a small group of insiders to retain control over key corporate decisions out of proportion to their actual economic ownership.

Supporters argue that these structures can help founders pursue long-term strategies and protect innovative companies from short-term market pressure. However, they also weaken the principle of 'one share, one vote', reduce accountability and can leave minority shareholders with limited practical influence over key corporate decisions.

Why should pension schemes care?

Pension schemes are long-term asset owners investing on behalf of their members. As such, their governing bodies are expected to consider financially material risks when defining their investment strategy and setting their approach to stewardship in their statement of investment principles (SIP) or investment strategy statement (ISS).

Dual-class share structures are most common in the US. Around 10% of US-listed companies use them, although adoption among newly listed companies is substantially higher. One-quarter to one-third of recent IPOs have employed unequal voting rights, with the practice particularly prevalent in the technology sector. In the UK, recent reforms to the listing regime have made it easier for companies with unequal voting rights to list, reversing a historically more cautious approach.

Potential exposure to dual-class share structures is wide-ranging and may occur through passive index-tracking funds, diversified growth funds or global equity allocations, in addition to active equity mandates. Therefore, governing bodies who do not select individual securities still need to understand how their managers and index providers approach these structures.

The challenge for investors

For investors, dual-class share structures create a gap between economic ownership and control. Enhanced voting rights can allow insiders to retain disproportionate influence over strategy, capital allocation, board composition and executive pay. They also limit the ability of ordinary shareholders to hold company leadership to account.

Over time, controlling shareholders can become entrenched, even after the original rationale for special control has fallen away. These share structures can also make stewardship signals harder to read. For example, voting outcomes that are reported only in aggregate may not fully reflect independent shareholders' views.

The popularity of dual-class share structures among technology companies raises further challenges for passive mandates. The so-called 'magnificent seven' tech stocks feature heavily in most global equity indices due to their large market capitalisation. Among these, Alphabet (Google) and Meta Platforms (Facebook, Instagram) use dual-class share structures. Investors can easily build up material exposure to such stocks without making an explicit governance choice.

We recommend schemes review their investment governance arrangements, as well as actively monitor and engage with their managers and index providers to assess how material these risks are for their portfolio.

What pension schemes can do

Investors have little ability to change these corporate structures directly. Exposure through passive indices, pooled funds and diversified mandates also makes it difficult to avoid them altogether. Schemes' governing bodies therefore mostly rely on their investment governance and stewardship policies, mandate design and manager oversight to manage potential conflicts with commitments to accountability and long-term sustainable value creation.

Schemes should start by setting clear expectations for corporate governance standards in investment beliefs and their SIP or ISS. Policy advocacy, whether directly with the government through consultation or through collaboration with other market participants – including asset managers – can also be a meaningful way to raise concerns.

Sector-wide stewardship and voting guidelines can provide a useful framework for setting expectations on voting and engagement. Schemes can also ask their investment managers to explain how they identify, vote on and escalate concerns about companies with unequal voting rights.

Schemes may want to consider alternative index methodologies and incorporate stronger governance safeguards, such as time-limited sunset provisions and protections for minority shareholders (which can protect against entrenched ownership), when designing mandates. Similarly, class-by-class voting disclosures can help better show whether independent shareholders supported or opposed management proposals. In more extreme cases where risks can't be mitigated, schemes may consider changes to manager or fund selection, and exclusions.

Summing up

Dual-class share structures are an increasingly visible governance issue for long-term investors. For tech stocks, the issue is amplified by these companies' growing weight in global indices. The accompanying governance and concentration risks may not always be adequately priced or compensated by the market. While schemes' ability to address the issue directly is limited, we recommend they review their investment governance arrangements, as well as actively monitor and engage with their managers and index providers to assess how material these risks are for their portfolio.

If you want to discuss dual-class share structures in more detail, please get in touch with the authors or your usual Hymans consultant.



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