CERF Fellowship Report
April 2021

Overview

My research has continued, in part, to centre around the use of dual-class stock by listed companies. It relates to my broader research into attracting listings in the UK and boosting the growth of the British tech-industry. Dual-class stock is a capital structure that enables founders to retain control through holding shares with disproportionately high voting rights, and issuing shares with lower voting rights, but equal cash-flow rights, to the public. Thereby, dual-class stock can allow a founder to divest of its investment in a company that he or she controls, and raise further equity funding on the public markets, while maintaining control.

I am currently writing a book on the subject of dual-class stock – 'Founders Without Limits: Dual-Class Stock and the Premium-Tier of the London Stock Exchange' which collates the academic evidence on dual-class stock from around the world and applies this evidence in the context of the premium-tier of the London Stock Exchange. My research has additionally led to two articles, which investigate two specific themes. The first relates to the UK's tech-industry and the existing prohibition of dual-class stock from the premium-tier. HM Treasury's recently released 'UK Listing Review' (3 March 2021) has recommended that the premium-tier should now permit dual-class firms, and my research evaluates the merits of relaxing the current prohibition. I assess the benefits and costs to public shareholders of dual-class firms within the UK's regulatory and market milieu. The second theme reviews the empirical history of dual-class firms in the US, where they have been permitted on the NYSE since the early 1990s (and on NASDAQ even longer), and where, in modern times, tech-companies have been adopting the structure in their droves. By assessing the existing empirical evidence in the US, a jurisdiction that resembles the UK's equity market in many respects, lessons can be learnt as to how dual-class firms may perform in the UK, if they became more prevalent subsequent to a relaxation of the premium-tier prohibition. The two articles are described below.

I have also commenced research, unrelated to dual-class stock, into the UK's Stewardship Code. The Stewardship Code encourages asset managers and asset owners to, *inter alia*, steward and engage with the firms in which they invest. The Stewardship Code was substantially up-dated in 2020, after the previous version of the Code attracted significant criticism, and my research assesses the propensity for the new version to more effectively encourage the issuer-specific engagement originally envisaged by the Code. The research scrutinises the Code by focusing on the legal, regulatory and commercial incentives, or lack thereof, for asset managers to undertake issuer-specific engagement. The paper also discusses hedge fund activism, and the likelihood for asset managers generally to exercise holistic-risk engagement of portfolio companies, including in relation to ESG factors.

Finding the British Google: Relaxing the Prohibition of Dual-Class Stock From the Premium-Tier of the London Stock Exchange

Abstract: There is a dearth of British tech-companies listing on the London Stock Exchange (LSE), and the LSE lacks a large, innovative tech-company such as Google. The UK Government, concerned as to the loss of UK tech-companies to foreign acquirors, views the encouragement of UK tech-firm listings as a policy priority. Dual-class stock, currently prohibited from the LSE Main Market's premium-tier, allows founders to list their firms, and retain majority-control, while holding significantly less of the cash-flow rights in the company. This article will broach the potential for dual-class stock to attract UK tech-company listings, and explore the benefits that dual-class stock can engender for UK tech-companies and their public shareholders. The risks of dual-class structures will also be discussed, but it will be shown that in a UK regulatory context, in relation to high-growth tech-companies, the risks may not be as severe as presumed, and easily moderated through judicious controls.

Progress: I have published my research in the Cambridge Law Journal (B. Reddy, "Finding the British Google: Relaxing the Prohibition of Dual-Class Stock form the Premium-Tier of the London Stock Exchange" (2020) 79 CLJ 315). <https://www.cambridge.org/core/journals/cambridge-law-journal/article/finding-the-british-google-relaxing-the-prohibition-of-dualclass-stock-from-the-premiumtier-of-the-london-stock-exchange/3D2E2F2CCFBF653D3151F7B2AC6E681F>

I was due to present my research at the Max Planck Institute for Comparative and International Private Law PostDoc Conference in Hamburg, but it was cancelled owing to the coronavirus situation.

I presented the paper in March 2020 at the Faculty of Law's (Cambridge University) conference on 'Funding Innovation: Current Issues in Corporate Finance'.

I will also be presenting the paper in May 2021 at the CERF Cavalcade.

More Than Meets the Eye: Reassessing the Empirical Evidence on US Dual-Class Stock

Abstract: Some of the largest and most successful publicly traded companies, such as Alphabet and Facebook, have implemented a capital structure known as dual-class stock. Dual-class stock enables a company's controller to retain voting control of a corporation while holding a disproportionately lower level of the corporation's cash-flow rights. Dual-class stock has led a tortured life in the US, and is perhaps the most controversial area of corporate governance today. Between institutional investor derision and the exclusion or restriction of dual-class stock from certain indices, one may assume that dual-class structure must be harmful to outside stockholders. However, in this article, the existing empirical evidence on US dual-class stock will be reassessed by contrasting studies that use different measures of performance. It will be shown that although dual-class firms are generally valued less than similar one-share, one-vote firms, they perform as well as, and in many cases, outperform, such firms from the perspective of operating performance and stock returns. When it comes to dual-class stock, more than meets the eye, and a presumption that dual-class stock is harmful for outside stockholders should not guide policy formulation.

Progress: I have completed a working draft of this paper, available at: <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3554428>

This paper has been accepted for publication in the University of Pennsylvania Journal of Business Law.

The Emperor's New Code? Time to Re-Evaluate the Nature of Stewardship Engagement Under the UK's Stewardship Code

Abstract: John Kingman's review of the Financial Reporting Council (FRC) doubted the effectiveness of the UK's Stewardship Code in encouraging informed and engaged stewardship by institutional investors of the companies in which they invest (issuers). Accordingly, the FRC published the Stewardship Code in 2020 in a final opportunity to prove its effectiveness and relevance, and, in particular, enhance issuer-specific engagement by institutional investors. The up-date has enhanced the reach and substance of the code. However, the legal, regulatory, contractual and competitive environment in which institutional investors exist will constantly forestall soft-law attempts to foster greater issuer-specific engagement, a point perhaps tacitly acknowledged by the 2020 Stewardship Code with its wider scope. Instead, in relation to engagement, stewardship disclosure should focus on the types of engagement that institutional investors are motivated to exercise in practice, such as engagement in response to hedge fund activism, and engagement on systemic risks.

Progress: I have completed a working draft of this paper, available at: <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3773156>

Bobby V. Reddy, April 2021