

## Dual-class share structures: failing to deliver?

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On 31 March 2021, Deliveroo plc undertook its highly anticipated initial public offering (IPO), listing on the standard segment of the Main Market of the London Stock Exchange (LSE). Shares in the food delivery app closed on the opening day of trading at 287p, 26% down, with further falls since.

In examining the reasons for the poor performance of the IPO, it has been widely reported that the company failed to win the backing of many of London's biggest investors, that flagged the company's dual-class share structure as being one of their concerns.

### Dual-class structures

Dual-class share structures are a hot topic in the UK. They give certain shareholders, such as founders, employees, or pre-IPO investors, enhanced voting rights over other shareholders that are disproportionate to their economic interests. They are permitted and relatively common in the US, and companies such as Facebook, Google and LinkedIn have these structures. However, the Financial Conduct Authority's (FCA) Listing Rules currently prevent companies with dual-class structures from being admitted to the LSE's premium segment, albeit there have been recent proposals to relax these restrictions following the review by Lord Jonathan Hill (the Hill review) (see *News brief "UK Listing Review: closing a gap"*, [www.practicallaw.com/w-030-2530](http://www.practicallaw.com/w-030-2530)).

In the meantime, dual-class share structures are permitted on the standard segment of the LSE Main Market. A number of companies, such as THG plc (the Hut Group) and Sir Martin Sorrell's S4 Capital plc, have opted for standard listings and provided for dual-class share structures, despite the perceived lesser reputation of the standard segment and the lack of eligibility for inclusion in UK indices such as the FTSE 100.

### Key advantages

Proponents of these structures say that they bring a number of key advantages to a company.

**Focus on long-term strategy.** It is argued that dual-class share structures can mitigate the pressure on a founder and the board to focus on short-term financial targets at

the expense of long-term strategy. This is seen as particularly relevant to high-growth businesses, such as founder-led technology companies, which typically seek to continually innovate in an effort to create long-term shareholder value, rather than focusing on quarterly revenue and profit targets. Indeed, the Hill review highlighted that the existing premium segment restrictions on dual-class share structures are seen as a key barrier to those high-growth companies choosing to list in the UK.

**Transition period.** The Hill review identifies an IPO as being both a sign of success but also a time of vulnerability for an issuer. A company may be yet to execute its vision of growth, but nonetheless become vulnerable to shareholder activism (including shareholder proposals that seek to effect board change) or hostile takeovers, having not fully built up the faith and goodwill within its shareholder base that is necessary to avoid those types of actions. It is argued that dual-class share structures, particularly those which have time limits or sunset provisions, may provide a transition period during which a founder is able to ensure that control is retained so as to execute the vision for the business. Once the transition period expires, the share structure reverts to a more usual "one share, one vote".

### Investor concerns

A number of concerns have been raised by institutional and other investors in respect of dual-class structures.

**One share, one vote.** This principle has long been seen as a bedrock of investor protection and ensures that the management of a company remains accountable to investors at all times. Providing enhanced voting rights to certain individuals or groups erodes this important principle and allows those persons to dominate decision-making without the full scrutiny of those providing the company's capital.

This issue was specifically cited by Legal & General Investment Management in explaining its decision not to participate in the Deliveroo IPO: "We believe in the active ownership of the companies in which we invest, and think change from within can be the most impactful way to influence positive

change in a company, for employees and shareholders alike."

To allay some of these concerns, the Hill review argued that enhanced voting rights should be limited to ensuring that enhanced voting rights apply only to certain limited situations, namely the holder of the relevant shares should be able to ensure that they remain as a director (in the case of a founder) and be able to block a takeover.

**Entrenched founders.** Dual-class share structures have the effect of concentrating voting control in those holding the relevant shares. This could lead to conflicts between entrenched founders and the company's other shareholders; for example, where a founder enforces a strategy of high spending in order to fuel growth, against the wishes of investors.

**Impact on trading price of the shares.** While the intention of dual-class share structures is commonly to enable founders to drive shareholder value, it is argued that these share structures may, in fact, result in a lower market price of a company's shares, as investors price in the relative loss of voting control. Indeed, the dual-class share structure adopted by Deliveroo has been specifically highlighted as a reason for the poor performance of its shares on IPO, but it should be noted that this was coupled with concerns about the company's treatment of its riders as self-employed (meaning they have few protections and no employment rights), and the company's reportedly high valuation.

### Future change

The FCA set out in its public response to the Hill review that it will consider all the relevant recommendations carefully, including on free float, dual-class share structures, and special purpose acquisition companies (SPACs) ([www.fca.org.uk/news/statements/fca-welcomes-lord-hills-listing-review-report](http://www.fca.org.uk/news/statements/fca-welcomes-lord-hills-listing-review-report)). It intends to publish a consultation by the summer 2021 on these areas, along with a specific, earlier consultation on SPACs.

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