

Asian Shadow Financial Regulatory Committee

The Momentum for Listing Dual Class Shares in Asia

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Dual class shares (DCS) are those where two different classes of shares have different voting rights disproportionate to the level of ownership. Unlike the situation in the United States and Europe, until recently DCS have, in general, not been allowed to list on stock exchanges within Asia. Recently, however, there has been a trend away from this position with Japan, Hong Kong, Singapore, Korea and Indonesia permitting the listing of DCS. In part, financial market development in Asia, alongside improvements in corporate governance practices, has enabled these countries to adopt the DCS system.

This momentum for change appears to be accelerating as other countries within Asia are also considering to adopt this position. One reason for this trend is the desire of countries to encourage the development of new tech companies. Another is to boost listings on home exchanges or exchanges where the company has a significant presence by allowing companies with dual classes of shares to list.

The main argument in favor of DCS listings is that it allows original owners of companies to go to the market to raise capital without giving up their control. In the case of companies where human capital is particularly important, such as new tech companies, maintenance of control by original owners allows them to carry out their vision and invest in the long term for the benefit of all shareholders. Without the possibility of DCS listing, these companies may not be listed publicly, depriving the public of the opportunity to invest in such companies.

However, there are clear agency issues to consider. There is a possibility of entrenchment: either incompetent managers are allowed to continue managing the company, or company managers act only to enhance private benefits. Another agency problem is that as DCS creates a wedge between control rights and cash flow rights of controlling shareholders, there is an incentive for controlling shareholders to pursue private benefits at the expense of other shareholders. As this wedge increases, corporate cash holdings are worth less to outside shareholders and CEOs tend to receive higher compensation. In addition, capital expenditures contribute less to shareholder value or may even be value destroying.

It is well known that in Asia that the main agency problem is the one between controlling shareholders and individual shareholders. Introduction of DCS would exacerbate this agency problem because the controlling shareholders would become more powerful.

In order to address this worsening agency problem, DCS should only be introduced in individual countries in Asia if corporate governance systems are first strengthened. To reinforce these corporate governance systems in Asian countries, the following policy reform measures must be implemented or improved upon:

1. Majority of the board of directors should be independent
2. More reliable financial statements and better disclosure
3. Stronger internal compliance and controls
4. More active shareholders meetings; ordinary shareholders' rights are strengthened and protected
5. Greater independence of external auditors
6. Better investor education

In the view of the Asian Shadow Financial Regulatory Committee (ASFRC), most Asian countries have to strengthen national safeguards with respect to different elements of their corporate governance systems in conjunction with the introduction of DCS. Without strengthening some of these safeguards, DCS cannot be implemented in an adequate and a responsible way.

As noted by the ASFRC in its first statement issued 20 years ago in July 2004, enhancing further regional financial integration in Asia would require creating an additional layer of financial infrastructure. Although the Committee could foresee such pan-Asian initiatives to gain ground, for the near future, Asian countries should focus on strengthening their national corporate governance regimes based on global standards.