The creation of dual-class share structures allows founders and early investors to retain control of a company through special shares with outsized voting rights. There is a clear multi-year trend towards dual-class share structures among the largest Silicon Valley companies, with their use tripling since 2011 and America accounting for the majority. At Baillie Gifford, roughly 10% of the companies in our clients' portfolios, or approximately 20% of funds under management, utilise dual share classes.

Google (now Alphabet), in its 2004 IPO, implemented a dual-class share structure allowing its co-founders Larry Page, Sergey Brin and CEO Eric Schmidt to keep control of the company. Latterly, firms such as Facebook, LinkedIn and Alibaba have followed suit with their own versions.

The dual-class strategy isn't new. Traditional media companies and other old-line businesses have used the approach for decades, often to preserve a family's influence. News Corp., Viacom Inc. and New York Times Co., for example, give a disproportionate amount of voting power to founding members. Several media companies have said that this offers insulation from the vagaries of the public market and can help protect a news outlet's editorial independence.

Other defenders claim that the structure allows them to focus more on long-term performance than on short-term returns, and means they are accountable to stakeholders not just shareholders. Alphabet and Alibaba have been unequivocal that the company's mission and chosen capital structures are for the benefit of the business and all stakeholders, not just shareholders. For example, Jack Ma ranks shareholders number three behind customers and employees.

One of the main arguments that companies use to justify their decision to adopt dual-class shares is the unique value their founders, as main decision makers, bring. The success of these companies depends directly on the distinctive vision of the founders and then their ability to set the course for the business and to raise money in order to execute those plans. This is illustrated by Alphabet, Facebook and Alibaba which relied on their founders' visions. A great example was Facebook's purchase of Instagram which occurred much to the consternation of its shareholders, but has ultimately been a positive investment for both the founders and all other shareholders.

Would shareholders consider Alphabet employees' free meals, massages, haircuts, gyms, and swimming pools as maximising shareholder value? Or what about the famous management model, in which employees are expected to spend 10% of their time on ideas unrelated to their job? These are the policies that seem to provide an atmosphere of innovation from which the ideas of Google Maps/Earth, self-driving cars, Google ventures and Calico (Alphabet's Biotech arm dedicated to understanding ageing) were derived.

Alibaba Chairman Jack Ma.

Alibaba insists it is this governance structure which helps maintain and strengthen its culture. This enables its partners, key people who manage the businesses, to set the company's strategic course without being influenced by the fluctuating attitudes of the capital markets and thus protect the long-term interests of customers, the company and all shareholders.

Importantly, this structure also enables the company to sustain innovation and continually improve the talent pool – those who run the business.

The short-term/long-term dichotomy has been exacerbated by an unprecedented level of pressure from activist shareholders over recent years. Activists claim that their goal is the long-term profits of the company, but the reality seems to be a bit different. Companies afraid to become the next target of an activist investor might make decisions to flatter the next set of quarterly results, irrespective of what that might mean for their long-term success.

Short-termism is rife on Wall Street: the average holding period on the New York Stock Exchange has tumbled from eight years in 1960 to four months. Of course, we cannot claim that investors are monolithic. However, many are short-term focused, and the fact that holding periods have dropped so dramatically indicates that there are significant changes in the market. Some activist investors use a variety of approaches to achieve a near-term increase in the company's share price – without considering the longer-term outlook. In fact, 84% of activists exit their investments within two years.

Additionally, dual-class structures can make public listings more attractive for closely-held corporations. More and more companies are shying away from the public markets. In those circumstances, perhaps retail and institutional shareholders should not complain about making concessions in exchange for the opportunity to invest in potentially high growth, high return stocks.

However, many feel the accountability to shareholders is important for a wide range of issues, including boardroom diversity and environmental practices. As companies expand into new markets and acquire more clout, it is more important than ever for shareholders to have a say. Some suggest that for companies to vertically and horizontally integrate and to become mega-companies of the world, they must be accountable to the people who made them so wealthy.

Google (now Alphabet) offices near the city centre in Dublin.
© Cathal McNaughton/Reuters.

Other criticisms of dual-class structures are based on accusations that they will be abused by management to extract private benefits at shareholders' expense. This may be true thematically. However, there have also been numerous examples of such behaviour at companies with single class shares. If dual-class structures are regularly abused, investors will be more reluctant to invest, a move which would affect valuation and the cost of capital, so making them less attractive. While it might be true that dual-class structures hand increased control to the management, this in turn places greater emphasis on the due diligence process of investors and disclosure requirements from regulators. Although shareholders accept significant risk when investing, the asymmetry of returns means they are also positioned to benefit most if a company performs well.

It seems that the main driver of success is not whether a company has multi-class shares, but whether it possesses the ability and room to innovate, to focus on the changing needs of customers and to create a challenging atmosphere for its employees. Facebook, Alibaba and Alphabet seem to have been able to benefit from a dual-class structure and invest in innovation and the search for new business possibilities – a perfect example of how a dual-class structure can help to achieve long-term results, while the board of directors is insulated from outside pressures.

Voting Activity

Votes Cast in Favour		Votes Cast Against		Votes Abstained/Withheld	
Companies	2	Companies	1	Companies	None
Resolutions	29	Resolutions	2	Resolutions	None

Corporate Governance is about accountability to stakeholders, not just shareholders

Dual-class share structures are increasing, with Silicon Valley companies leading the trend

Dual-class structures allow for an increased focus on long-term performance

Firmwide Company Engagement

Engagement Type	Company
AGM or EGM Proposals	Whole Foods Market Inc.

Notes on company engagements highlighted in blue can be found in this report. Notes on other company engagements are available on request.

Votes Cast in Favour

Company	Meeting Details	Resolution(s)	Voting Rationale
Whole Foods Market	Annual 09/03/16	5	We supported a shareholder resolution requesting amendments to the company's proxy access bylaw as we believe it is in shareholders' best interests.

Companies	Voting Rationale
Novozymes, Whole Foods Market	We voted in favour of routine proposals at the aforementioned meeting(s).

Votes Cast Against

Companies	Voting Rationale
Whole Foods Market	We opposed a shareholder proposal which is too prescriptive.

Votes Abstained

We did not abstain on any resolutions during the period.

Votes Withheld

We did not withhold on any resolutions during the period.