Analysis of the Impact of Dual Shareholding Structures on the Governance of Technology-Based Firms

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Abstract. As a matter of fact, since the technological revolution, the use of dual shareholding structures has become more and more widespread in technology-based companies as the number of technology-based companies has increased. These start-ups with dual shareholding structures have grown rapidly and have been able to grow into large corporations in a relatively short period of time. On this basis, dual equity structure seems to be a perfect match for many technology-based companies. In order to explore the positive effects and risks of dual equity structure on the corporate governance of technology-based companies, this paper investigates, studies as well as analyzes the issues. According to the analysis, it is concluded that dual equity structure is favorable to consolidate the founder's control over the company, expand financing, but harms the interests of small and medium-sized shareholders, and is detrimental to the equality of shareholders. Overall, these results shed light on guiding further exploration of firm governance.

Keywords: Dual shareholding structure; science-based companies; governance implications.

1. Introduction

Corporate governance broadly refers to the supervision and control of the governing body over the object of governance, which is essentially the distribution and checks and balances of corporate control by company executives, board of directors, shareholders, etc., which profoundly affects the development of the company and corporate performance. As the most basic form of corporate governance, the shareholding structure is directly related to the ownership of the company and the control of the shareholders, which constantly affects the operation and development of the company [1-4].

The same-share, same-rights structure, which symbolises equality and equal rights, has the widest application in corporate governance in the capital markets of various countries, but the dilemma of increasing capital or strengthening management rights makes it not the only system of shareholding structure. Since 1898, when the U.S. International Silver Company adopted the dual shareholding structure, although scholars, executives, and shareholders have always had reservations about the dual shareholding structure and there are big differences, the dual shareholding structure has always been active in the Western securities market and legally recognised. 1970s, the rise of the scientific and technological revolution, which has given rise to a lot of science and technology-based companies in the M&A, takeover of the enterprise founder, the proprietor In order to prevent hostile mergers and acquisitions and dilution of management rights, some companies have adopted the shareholding structure of different rights for the same shares through restructuring and other means. Since then, the dual shareholding structure has been favoured by many start-up companies and has gradually gained legal recognition and protection in its wide application [5-7].

2. The Concept of Dual Shareholding Structure and the Current State of Development

Dual shareholding structure, in simple terms, means "different rights for the same shares".The company issues two different types of shares, A and B, and establishes a special internal institutional arrangement to enable minority shareholders to take control of the company; as the chart shows, class A shares enjoy "one share, one vote" on the basis of the "one share, one vote" principle of equality,

while Class B shares, as super shares, have several times or even tens of times the voting rights, and are generally prohibited from public trading. Class A shares are entitled to "one share, one vote" on the principle of equality, while Class B shares, as super shares, have several times or even dozens of times the voting rights and are generally prohibited from being publicly traded, helping minority shareholders to become the actual controllers of the company (seen from Fig. 1 and Fig. 2) [7-9].

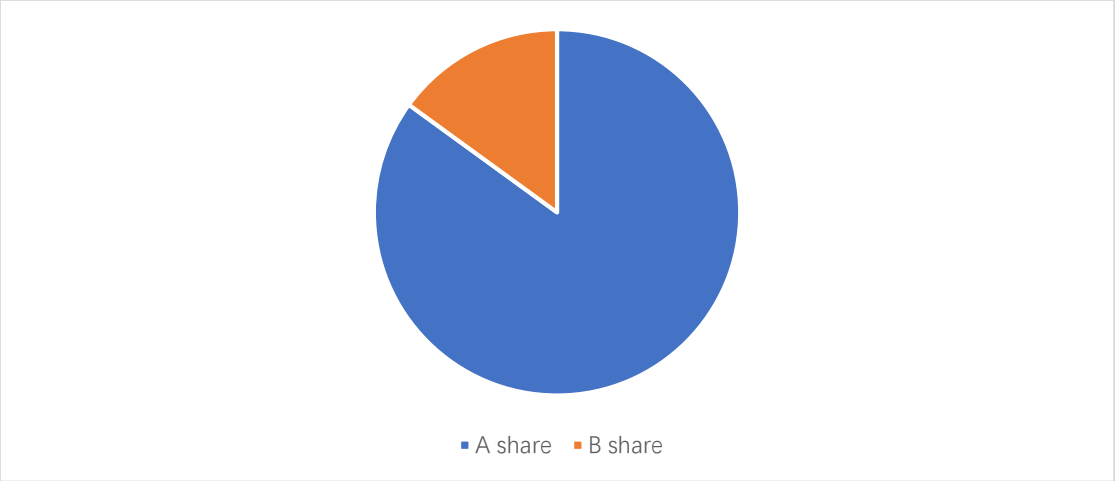


Fig. 1 The percentage of share

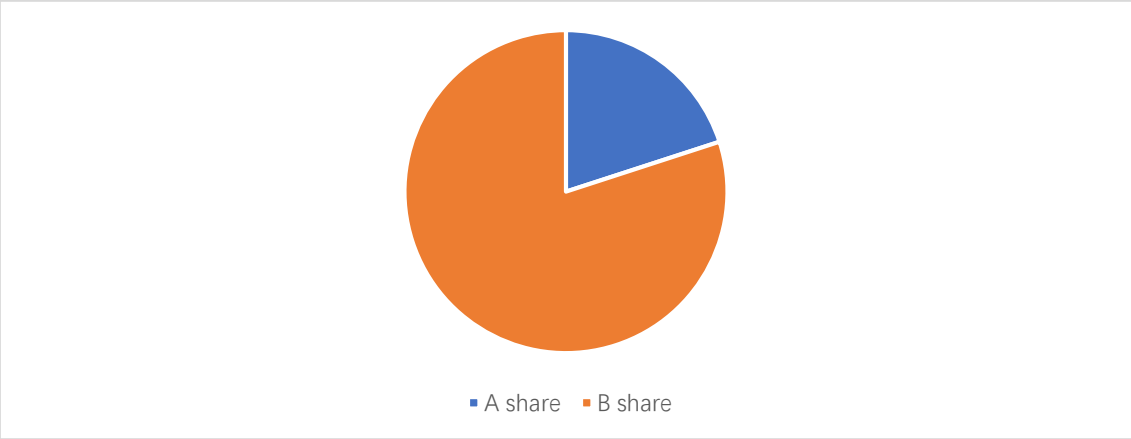


Fig. 2 The right to vote.

In order to improve the highly concentrated shareholding situation in China, the Hong Kong Stock Exchange issued a new regulation in 2018 to allow the listing of companies with dual shareholding structure, and introduced the structure of different shares and different rights on the Science and Innovation Board in June 2019, which alleviated the strong demand for dual shareholding structure of China's science and innovation-based companies.Since the listing of UXD on the S&IEB after adopting a dual shareholding structure in January 2020, as the number of science and innovation-based companies in recent years has been number has been increasing, the proportion of companies adopting dual shareholding structures has continued to rise, with Jingdong, Xiaomi, Meituan, Pinduoduo, Baidu, NetEase, Weibo, Ctrip and other tech-venture companies adopting dual shareholding structures.

3. Positive Effects of Dual Shareholding Structures on the Governance

The attribution of corporate control and operating rights has always been a top priority in corporate governance issues. Li and Han argued that the dual shareholding structure enables the founders to obtain the majority of voting rights with a lower shareholding, maintain control of the company, the most basic decision-making power and the right to decide on the operation of the company [5]. The data in table show that different levels of control over a company result in different returns on equity

and market returns. The founders have the control of the company, can inspire their sense of responsibility for the company, naturally pour more enthusiasm and effort into the company, put more of their creativity into the project itself, create more use value, and maintain the keen sense of discerning the market winds and the spirit of innovation and creativity of science and innovation-oriented companies, and at the same time, make them think about the direction of the development of the company in the long term to achieve the company's long-term development and enhance the company's overall efficiency, and avoid investors' profits and profits. At the same time, it enables them to consider the development direction of the company in the long term, realise the long-term development of the company, improve the overall efficiency of the company, and avoid the negative impact on the sustainable development of the company caused by the "short-sighted" thinking of investors who prioritise profits. Shen points out that the proprietor's unique insights constitute the core competitiveness of a company with a dual shareholding structure, and that the success of the business strategy corresponding to the proprietor's unique insights can bring the company returns that exceed the market level, and distinguish the company from its competitors in the market. However, the asymmetry of information between the operator and the minority shareholders often prevents them from fully appreciating the value of the insight [6]. Summary of 3 companies are shown in Table 1.

Table 1. Summary of three selected companies.

	Xiaomi	Meituan	Alibaba
IPO Discount Rate	-1.2%	5.3%	6.6%
Return on Equity holdings	-24.5%	149.1%	19.1%
Hang Seng Index yield	-14.9%	-11.1%	-9.2%
Liability	18.5%	5.7%	18.1%
Common Stock	81.1%	94.4%	66.3%
Return on Equity	13.2%	2.5%	15.4%
PE ratio	18.0	160.7	26.2

Adequate capital is one of the keys to the sustainable development of science-based companies, but high interest rates on private loans and the lack of collateral for companies make it difficult to obtain bank loans. To obtain capital, it is a very safe and stable way for science-based companies to use dual equity structure to access the capital market to raise capital. Chen in discussing the corporate practice of dual shareholding structure, concludes that the characteristics of the B-share super-voting rights of dual shareholding structure enable the management team to raise funds by releasing A-shares without having to dilute their control over the company, which fends off a control buyout, thus enabling them to implement a long-term strategy for the development of the company [7]. The use of dual equity structure to introduce investors to conveniently obtain the funds needed for development in science-based companies not only solves the problem of the source of funds for science-based companies, which strongly supports the development of the company, but also avoids the dilution of the founding team's control of the company's operation and management rights, and dispels the founding team's concerns about the company's listing, so as to achieve the sustainable development of the company. In addition, Zhang and Li argue that technology-intensive science and innovation companies are easy to be taken over in the capital market due to the low proportion of physical capital and the high volatility of corporate valuation [8], but in the dual shareholding structure of the B-shares, which account for the decisive voting rights, are not listed and circulated, and the acquirer is not enough to have controlling voting rights even if it holds all the low-voting shares circulated in the market, which can avoid the malicious takeover of science and innovation companies. companies from hostile takeovers.

With the gradual development and transformation of modern corporate governance, the demands of different shareholders on the financial and managerial interests of the company are gradually separated, the founding shareholders pay more attention to the control of the company, i.e., the acquisition of managerial interests of the company, and the minority shareholders, who are trapped

in the decentralisation of the capital market and collective action, pay more attention to dividends brought by the shares, i.e., the acquisition of financial interests of the company [9]. The dual shareholding structure satisfies the diversification of shareholders' demands and reflects the concept of corporate autonomy. Investors can be liberated from the company's work and devote their energy to other projects to earn more profits, while the company's management team can enjoy more management rights and make decisions quickly and efficiently, which enhances the high performance of corporate governance and guarantees the planning and implementation of the company's strategy.

4. Risk Challenges of Dual Shareholding Structures to the Governance

The absolute power of the founders to make strategic decisions given by the dual shareholding structure may be detrimental to the interests of small and medium-sized shareholders. Without the constraints of equity capital, the founders have absolute say over the company's operation, management and development, which may easily lead to the founders' arbitrariness, ignoring the interests of shareholders, and even placing the acquisition of profits as a secondary position in the management of the company. If the founders fail to respond to changes in the external environment and make decisions accordingly, the loss of profits will have to be borne by all shareholders in proportion to their shareholdings. In addition, despite the existence of market monitoring mechanisms and mechanisms to protect shareholders' interests, dominance over the company may still lead to founding shareholders abusing resources or making profits in connected transactions of the company to the detriment of small and medium-sized shareholders interests. With regard to the above viewpoints, Chi and Chen argued that under the dual shareholding structure [10], the separation of voting rights and cash flow will create a principal-agent problem, and the excessive control of the founding team and the lack of decision-making and supervisory rights of small and medium-sized shareholders may lead to the founders to make decisions more favourable to themselves when they do not have the same interests as the other shareholders, which is detrimental to the interests of the other shareholders.

A dual shareholding structure allows corporate controllers to avoid market oversight and is contrary to the principle of equality of shareholders. Market oversight mechanisms can make managers committed to improving the company's performance and, to some extent, prevent them from doing things that are detrimental to the interests of other shareholders. In an efficient market for control, managers may be fired if they use their power for personal gain or if their performance declines, but under a dual shareholding structure, the beneficial owner of the company has absolute power and hardly needs to consider the pressure from the market for control at all. The concept of equality has made the principle of equal shares and equal rights unassailable in the judicial world, and very few countries still prohibit the use of dual shareholding structures today. Wang argues that the significant shortcomings of the dual shareholding structure in terms of the principle of equality of shareholders can directly undermine the foundation of the dual shareholding system [11]. As it is difficult to quantify and equalise financial and managerial interests, the dual shareholding structure may tilt the interests in favour of the controlling shareholders, especially in the rapid expansion stage of technology-based companies, which may easily lead to disputes over profit sharing, resource allocation and even business direction, which will have a negative impact on corporate governance and may even lead to the stagnation of the company's development [12-14].

5. Conclusion

From the scholars' research on the impact of dual shareholding structure on the governance of science-based companies, it is easy to see that dual shareholding structure has both positive and negative effects on science-based companies. The positive effects of dual equity structure on science-based companies are mainly reflected in the fact that the several times or even dozens of times of voting rights brought by the dual equity structure for the founders of the company well ensures that

the founders are in control of the company, which helps to maintain the founding team's sense of responsibility for the science-based company, and constantly stimulate the innovation and creativity of the science-based company. The expansion of financing avoids the pitfalls of high up-front investment costs for start-ups, allowing them to build innovative, market-driven products and grow their markets quickly and steadily, without being sidetracked by the profit-seeking nature of new investors. This has fuelled the "myth of the start-up" that many start-ups grow quickly.

However, the accompanying risk and challenge is that the concentration of management and control by the founders leads to a lack of effective oversight and compromises the interests of small and medium-sized shareholders. Expansion of the company's size can amplify and intensify these problems and conflicts. At this point, the dual shareholding structure is not conducive to the company's ability to achieve solidity in its current size. In addition, the dual shareholding structure to satisfy the diversified demands of shareholders deviates from the principle of equality of shareholders and does not have a firm legal footing, which is not conducive to the long-term development of dual shareholding structure in technology-based companies.

Looking forward to the future development of dual shareholding structure and technology-based companies, in order to achieve better integration and development of dual shareholding structure and technology-based companies, give full play to the positive effects of dual shareholding structure on the corporate governance of technology-based companies and reduce the negative impacts, one can start from the construction of the company's system, appropriately reduce the voting rights of the class B shares, achieve the optimisation of the use of the dual shareholding structure in the technology-based companies, and ensure the founder's dominant position while allowing other shareholders to have more influence. dominant position while allowing other shareholders to participate more in corporate governance and make collective efforts to make the development of the company more stable; it can also improve the internal and external supervision mechanism, refine the content of the independent director system, strengthen the supervisory board's supervisory power, and make the supervisory body intervene at important nodes, such as public transfers of Class B shares, to not only achieve the purpose of the use of the dual shareholding structure by the science and innovation company to solidify the right of control and expand financing, but also to It not only achieves the purpose of using dual shareholding structure to solidify control and expand financing, but also prevents the abuse of operation and management rights, protects the rights and interests of small and medium shareholders, and avoids the risks brought by dual shareholding structure. With the optimisation of dual shareholding structure in the practice of the company and the improvement of the supervision and regulatory system, the governance structure of technology-based companies will become more and more balanced, and the contradiction between development and governance will be effectively balanced, while the deviation of dual shareholding structure from the principle of equality of shareholders will also be gradually reduced. The perfect combination and common development of technology-based companies and dual shareholding structure can be achieved.

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