The Optimal Path for Chinese Enterprises to Adopt a Differentiated Voting Rights System: A Case Study of Magna International

Yuejia Niu

School of Economics and Management, North China University of Technology, Beijing, China

24102020118@mail.ncut.edu.cn

Abstract. Differentiated voting rights systems, as an important tool for balancing cor-porate financing needs and maintaining control, are widely used in global capital markets. However, they are also associated with numerous govern-ance risks. This article uses the case of Magna International, a Canadian company, to systematically analyze the risks associated with its differentiat-ed voting rights system. At the same time, it focuses on extracting the experience of the company's subsequent governance reforms, such as optimizing the decision-making process through the power check and balance mechanism and strengthening the transparency of information disclosure. Drawing on its experience with governance reforms, this article addresses the current state of the differentiated voting rights sys-tem in China’s Science and Technology Innovation Board (STAR Market). The article proposes optimization paths, including improving the limited resolution system, implementing a class shareholder voting mechanism, es-tablishing a lead independent director system, and strengthening exit mecha-nisms. These paths provide a reference for Chinese companies to utilize this system in a standardized manner.

Keywords: Differentiated Voting rights System, Corporate Governance, Risk Prevention and Control, Dual-class Shares, Sci-Tech Innovation Board.

1. Introduction

In the global capital market's response to the financing needs of innovative enterprises, the differentiated voting rights system breaks through the traditional "one share, one vote" principle. By separating voting rights from cash flow rights, it provides institutional guarantees for the founding team to maintain control after multiple rounds of financing, becoming an important tool for balancing corporate development and control stability [1]. The global practice of this system presents a "double-edged sword" feature: the United States, Canada, and other markets adopted this model early, which not only cultivated industry giants such as Google and Magna but also promoted rapid decision-making and expansion during the growth period of enterprises. However, due to the imbalance of power, it also exposed governance disputes, from the self-interest of management to the damage to the rights of small and medium shareholders, highlighting the deep contradiction between institutional design and risk prevention and control.

In 2020, UCloud Technology Co., Ltd. (UCloud) listing on the STAR Market marked the full implementation of this system in China. As of 2024, eight companies listed on the Science and Technology Innovation Board (STAR Market) have adopted this model, with a focus on high-tech fields. Their average R&D investment is significantly higher than the sector average, making them an important contributor to the development of STAR companies [2]. However, the problem of capital occupation caused by the three founders of UCloud holding 60.06% of the voting rights with a 23.12% stake also reflects the risk of power abuse in my country's practice and highlights the need for system optimization [3].

As a leading transnational manufacturing company, the case of Magna International is of special value. Unlike light-asset technology companies, the dual-class share structure of this global auto parts giant (Class A shares with 500 votes per share and Class B shares with 1 vote per share) not only helped it grow from an annual sales of less than US$100 million to a company with over US$10 billion in sales in the early stage, with its stock price rising by 520.29% from 1984 to 1997, but also led to a governance crisis in the later period because its founder, Stronach, controlled 75% of the voting rights with a 3% stake. In 2009, its stock price fell by 67.26% from its peak [4]. This process of "prosperity and hardship due to equity" provides a unique example for traditional manufacturing. Compared with technology companies, traditional industries with heavy assets and long industrial chains have higher requirements for governance stability, and institutional design needs to place more emphasis on checks and balances. This perspective is often overlooked in existing research, making its case of traditional industries of great reference value for institutional design in conventional industries.

At present, the core issue of the differentiated voting rights system is: how to protect the founder's control to maintain strategic stability while preventing the abuse of power and balancing the interests of shareholders? This contradiction is reflected in Magna as an imbalance between voting rights and responsibilities - the founder holds absolute say with a small amount of equity, but does not need to bear equal responsibility for irrational investments such as involvement in theme parks and horse racing, resulting in resource dispersion and shareholder losses [5]. In my country's Science and Technology Innovation Board, it is manifested as an imbalance between special voting rights and ordinary shares, such as the capital occupation problem of UCloud [3]. Based on this, this article uses Magna as a sample to extract its rectification experience of restricting the founder's power and strengthening supervision, and combines the current situation of restrictions on voting rights multiples and holder qualifications in my country's "Science and Technology Innovation Board Listing Rules" to propose an optimization path. Comparing and verifying the universality and limitations of the case, it provides a refined reference for the system selection of different industries [4].

2. Overview of Magna International Inc

Founded in 1973, Magna International Inc. of Canada is a highly diversified global automotive parts supplier. In its early days, the company adopted a two-class stock structure: Class A shares each had one vote, and Class B shares each had 500 votes. Founder Frank Stronach has been the controlling shareholder since 1978 and has always held Class B shares. With a 3% stake, he controls 75% of the company's voting rights [6]. In the early days, the company developed rapidly through dual-class shares, growing from annual sales of less than \$100 million to a company with over \$10 billion in sales. From 1984 to 1997, the stock price rose from \$2.76 to \$17.12, an increase of 520.29% [7]. Later, it fell into operational difficulties, and in March 2009, the stock price fell to \$5.61, a drop of 67.26%.

3. Risks of Magna International's Differentiated Voting Rights System

3.1. Failure to Properly Perform Decision-Maker Proxy Duties

Magna's founder, Stronach, drove rapid growth during the company's expansion period with his astute judgment. However, due to a lack of checks and balances on his power, he later invested significant resources in non-core businesses: in 1997, he invested in a theme park and established a private airline, and in 1998, he ventured into the horse racing industry. These investments were not supported by a business plan and diverted resources from the core automotive parts business, resulting in the company's resources being dispersed and its core competitiveness being weakened. This "owner-absentee proxy" behavior is essentially an imbalance between voting rights and responsibilities. The founder, with a small stake, holds absolute control but is not held financially responsible for any misjudgments, further exacerbating the phenomenon of insiders abusing their power to satisfy their selfish desires.

3.2. Failure of Internal Checks and Balances

In order to maintain control and continue to control Magna, Stronach solidified his power through family relationships: in 1994, he appointed his son-in-law, Walker, as CEO, and in 2001, his daughter took over, forming a "family-style governance closed loop". Although the board of directors has internal control systems, the independent directors are subject to the power of the founder, resulting in their opposition to the excessively high salaries of the father and daughter and their non-related investments being futile. This also reflects that if the dual-class share structure is not implemented properly, it will make the supervision of management by public shareholders and common shareholders ineffective, hindering the normal performance of the board of directors' fiduciary responsibilities [8].

3.3. Serious Self-interested Behavior of the Founder and His Family

The serious separation of voting rights and cash flow rights has amplified the self-interested motivation of management. Under Magna's dual-class share structure, a significant phenomenon of "salary erosion of profits" has occurred: in 2006, Stronach's salary reached 27.7 million Canadian dollars, far exceeding the 9.5 million Canadian dollars of the CEO of General Motors in the same period, while the company's net profit increased by only 3% that year. This kind of interest transfer behavior not only directly harms the interests of shareholders, but also leads to the frustration of employee enthusiasm and the decline of organizational efficiency, forming a vicious cycle of "high cost-low performance". Data shows that when the company's stock price plummeted by 30% in 2002, Stronach still grabbed 52 million Canadian dollars in salary, and his daughter's salary also doubled, reflecting that the supervision mechanism is useless in the face of absolute power [6].

3.4. Damage to the Rights of Small and Medium Shareholders

In the case of Magna, although common shareholders hold 97% of the shares, they are unable to influence decision-making due to their weak voting rights. When the founder controls the majority of voting rights, dominates the operation of the shareholders' meeting, and occupies a dominant position on the board of directors, facing a series of irrational investments by the founder, small and medium shareholders cannot veto proposals through the shareholders' meeting, and due to the imperfect class action mechanism, it is difficult to protect their rights, resulting in a "free-rider" dilemma. When the company fell into crisis in 2009, common shareholders lost 67% of their shares, but lacked effective relief channels, highlighting the institutional gap in the protection of the rights of small and medium shareholders under the differentiated voting rights system [9].

4. Optimizing Differentiated Voting Rights Systems in Enterprises

4.1. Core Principles of System Design

Dynamic Balance: The Trade-off Between Control Stability and Shareholder Protection. The Magna case demonstrates that the core of a differentiated voting rights system is the dynamic balance between founder control and shareholder rights. In its early days, the company used Class B shares (500 votes per share) to safeguard founder control and support expansion. Later, when power imbalances led to crises, it implemented restrictions and a return to a "one share, one vote" system to curb abuse and restore shareholder trust. This reinforces the importance of establishing a dynamic mechanism for balancing control stability and shareholder protection in system design. This approach preserves founder strategic leadership to maintain decision-making consistency, while also ensuring gradual adaptation through clear boundaries of power, such as investment scope restrictions and compensation reviews, to prevent profiteering.

Industry Adaptability: The Differentiated Needs of Manufacturing and Technology Companies. Magna's practice highlights the differing requirements for voting rights systems between manufacturing and technology companies. Manufacturing, due to its heavy asset base and demanding high levels of industry chain collaboration, places a greater emphasis on governance stability and risk prevention. Its restructuring efforts, such as divesting non-related businesses and focusing on core businesses, address the inherent risk in resource dispersion. Technology companies, on the other hand, prioritize innovation efficiency and demand greater control and flexibility. Therefore, institutional design must adapt to industry characteristics: while manufacturing prioritizes checks and balances and strategic focus, technology companies can moderately relax control constraints to accommodate rapid iteration.

4.2. Optimization Path Proposal

Layered and Classified Equity Design. Differentiated rights are set according to the types of shareholders: founders, institutional investors, and employee shareholders. Founders retain strategic decision-making rights such as core business investment approval, institutional investors strengthen financial supervision rights such as auditing, and employee shareholding focuses on income rights and participation rights. The lesson from Magna is to maintain stable control through equity-type restrictions and avoid strategic fluctuations caused by equity dispersion, which is particularly critical in asset-heavy industries [10].

Strengthening the Constraint and Supervision Mechanism. From the perspective of investment direction control, it should learn from Magna's experience and establish a mechanism of prior constraint, in-process supervision and post-event rectification: the articles of association clearly define the scope of the main business, and non-related investments must be approved by the board of directors; two consecutive years of losses in non-core businesses trigger a restriction agreement to limit the voting rights of the founders; for projects that seriously deviate from the strategy, the board of supervisors is given the right to propose industrial restructuring [11]. In terms of the time limit of rights constraints, a time-based "sunset clause" is added, combined with an event-based mechanism: after 5 years, special voting rights are reduced by 50%, and after 10 years, they are completely converted to ordinary voting rights; if R&D investment, revenue growth rate, etc. meet the standards, they can be extended for 3 years by category voting, taking into account flexibility and incentives. Strengthen the supervision subject and introduce the centralized supervision model of Magna's chief independent director. The regulatory authorities recommend candidates from the talent pool and the directors are elected by the shareholders' meeting through a "one share, one vote" vote to avoid interference from the founders; grant them the right to investigate the abuse of special voting rights, link their remuneration to the effectiveness of supervision, and bear joint and several liability if no major violations are found, thus breaking the dilemma of independent directors standing by and watching [12].

Improve Information Disclosure and Investor Communication. Focus on strengthening the checks and balances of small and medium shareholders, introduce Magna's collective bargaining experience and class shareholder voting system: proposals related to shareholder interests, such as related-party transactions and executive compensation, must be approved by shareholders of each class of shareholders at a general meeting and with absolute majority approval before they can take effect, providing prior relief for disadvantaged shareholders based on the equality of shareholders [13]. At the same time, key matters will be included in the scope of class voting, requiring both common stock and special voting rights shareholders to pass the meeting to avoid "minority decision-making", and an online voting platform will be established to facilitate the participation of small and medium shareholders, making collective bargaining a normal practice.

Legal and Regulatory Adaptation. Promote inter-jurisdictional regulatory coordination to adapt to the cross-border operations of multinational manufacturing enterprises and avoid regulatory conflicts; learn from the experience of the SEC and implement higher disclosure standards for companies that adopt differentiated voting rights, and compel disclosure of information such as the separation ratio of control rights and cash flow rights and potential conflicts of interest to provide investors with a basis for decision-making. In addition, based on the research of scholars that the longer a company is listed, the weaker its potential advantages and the higher the cost of harming small and medium-sized shareholders, it is necessary to incorporate time-based "sunset clauses" and other constraint mechanisms into the regulatory framework to ensure a dynamic balance between institutional costs and benefits.

5. Conclusion

This article uses UCloud's listing on the STAR Market as a starting point and Magna International as a case study to systematically analyze the governance risks inherent in differentiated voting rights systems in practice, including issues such as founder abuse of power and ineffective internal oversight. It also examines Magna's experience in addressing these issues through measures such as restricting investment directions, strengthening oversight mechanisms, and ending its dual-class share structure. Drawing on the practical experience of my country's STAR Market, this article proposes targeted optimization strategies, encompassing constraints on founder investment behavior, strengthening checks and balances among minority shareholders, establishing a lead independent director system, and introducing a time-based "sunset clause."

Compared to Western countries, my country's differentiated voting rights policy started relatively late and still needs improvement. it should prioritize the benefits of differentiated voting rights and mitigate their drawbacks. Future research could further expand the sample size and compare the governance effectiveness of companies listed on the US, Hong Kong, and STAR Markets. This would provide a more refined basis for system optimization, more effectively curb the arbitrary behavior and favoritism of shareholders with special voting rights, and ensure that differentiated voting rights truly become a booster for the high-quality development of Chinese companies.

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