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COMPANY LAWYER BRIEFING

Do investors vote with their feet? Commenting on Deliveroo's IPO on London Stock Exchange and the dual-class share structure

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☞ keywords to be inserted by the indexer

In recent years, the dual-class share structure (DCS) has been widely debated by policymakers and academics in the UK and internationally in terms of its advantages, limitations, and regulatory challenges.[1] It is acknowledged that the DCS is beneficial for founders of tech enterprises whose equity interests and voting rights have been significantly diluted in the growing stage of their companies due to the need to obtain enormous funding from venture capital funds and other external investors. Therefore, it is common for tech entrepreneurs across the world to adopt the DCS which grants them disproportionate voting rights attached to a certain class of shares. For instance, Facebook Inc., the US social networking conglomerate, has issued two classes of shares. While each class A share carries one vote, the holders of class B shares would be able to cast ten votes per share. Its co-founder and CEO, Mr Mark Zuckerberg, having less than 13 per cent of Facebook's outstanding shares, controls 58 per cent of total votes.[2] Also, many Chinese tech companies like JD.com, an e-commerce giant competing with Alibaba, have adopted the DCS. The CEO of JD.com, Mr Richard Liu, despite possessing only 16 per cent of the company's shares, is able to exercise 83.5 per cent of the aggregate voting power.[3] Nonetheless, the DCS system has been widely criticised for breaching the fairness and equality principle as it is contrary to the classic doctrine of "one share, one vote" in company law.

The DCS originated from the US in 1890s when the International Silver Company firstly issued a class of shares with no voting rights. It had become prevalent in the 1920s but also received fierce criticisms. In response to the outcry of American investors, the DCS had been prohibited by the New York Stock Exchange from 1926 to 1985. However, the DCS revived in the 1980s because of its anti-takeover nature as well as the increasing competition among three US stock exchanges, leading to the deregulation of the DCS. Nowadays, the DCS has gradually gained global popularity due to the growing number of IPOs of tech companies. It has been permitted by major stock markets in Asia like Hong Kong, Singapore, and more recently, Shanghai Stoch Exchange's Star Market.[4] The lucrative IPO businesses render major financial centres to relax the listing rules to attract more tech firms incorporated with DCS. At present, the DCS system has been under review by the UK authorities. In November 2020, Chancellor Rishi Sunak launched the UK Listings Review which discussed the feasibility of the DCS in the Premium listing Segment of the London Stock Exchange.[5] In February 2021, the Kalifa Review of UK FinTech has endorsed DCS as a legal mechanism to improve the UK's listing environment.[6]

So far, tech companies with dual-class shares have been warmly welcomed by investors in the US an Asia who seem to pay more attentions to potential financial returns instead of the actual voting rights which, in practice, would not be exercised by most retail investors. For example, in April 2019, when Zoom, the videoconferencing software company, floated its shares

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[1] For example, see Bobby V. Reddy, "Finding the British Google: Relaxing the Prohibition of Dual-class Stock from the Premium-tier of the London Stock Exchange" (2020) 79 *Cambridge Law Journal* 315; Gao Fei, "Rethinking Dual-class Share Structure in the Context of China" (2019) 40 *Company Lawyer* 301; Huiqin Jiang, "Recent Developments in Singapore on the Listing of Dual-class Shares Companies" (2019) 40 *Company Lawyer* 189.

[2] Benjamin Robertson and Andrea Tan, "Why Dual-Class Shares Catch On, Over Investor Worries", *Bloomberg* (5 March 2021), *https://www.bloomberg.com/news/articles/2021-03-04/why-dual-class-shares-catch-on-over-investor-worries-quicktake-klwbtryg* [Accessed 12 July 2021].

[3] US Securities and Exchange Commission (SEC), "JD.com, Inc. Prospectus 2014", SEC, *https://www.sec.gov/Archives/edgar/data/1549802/000104746914009683/a2222411z424b4.htm* [Accessed 12 July 2021].

[4] Lerong Lu, "The Rising Star in the East: Unveiling China's Star Market, the Registration-based IPO Regime and Capital Markets Law Reform" (2020) 31 *International Company and Commercial Law Review* 394, 406.

[5] HM Treasury, "UK Listings Review (19 November 2020)", *https://www.gov.uk/government/publications/uk-listings-review#:~:text=The%20UK%20Listings%20Review%2C%20chaired,a%20leading%20global%20financial%20centre* [Accessed 13 July 2021].

[6] HM Treasury, "The Kalifa Review of UK FinTech (26 February 2021)", *https://www.gov.uk/government/publications/the-kalifa-review-of-uk-fintech* [Accessed 13 July 2021].

on Nasdaq, its share price surged 72 per cent at the end of the first trading day.[7] However, the recent debut of Deliveroo on London Stock Exchange has shown another story. Founded in 2013, Deliveroo is an online food delivery company and has been viewed as one of the leading tech companies during the UK tech boom. When Deliveroo announced its IPO plan in early March, observers thought this would signal a new era for the City of London after the Brexit as it is expected to showcase its attractiveness to tech start-ups. London aims to compete with international rivals like New York, Hong Kong, and Singapore in the increasingly crowded IPO market. However, on 31 March 2021, the Deliveroo's IPO turned out to a great shock to market observers and investors. Within the first 20 minutes of trading, Deliveroo's share price sank to 271p, 30 per cent below its initial offering price at 390p. It closed trading at 287p which was 26 per cent down.[8] This is probably the worst performed major IPO in London over the past two decades, especially when the current tech boom has greatly lifted the valuation of tech businesses and ignited investor interests.

The dismal IPO of Deliveroo could be attributed to multiple reasons. Some of the largest investment funds in the UK, including Aviva Investors and Aberdeen Standard, publicly opposed Deliveroo's listing amid concerns such as riders' rights and the use of DCS.[9] Deliveroo has long been criticised for its treatment of delivery workers who are not entitled to minimum wage, sick leave, and holiday pay. Its employment practice has been further condemned after the recent Supreme Court ruling on Uber drivers' rights. In *Uber BV v Aslam*, six judges unanimously decided to support the landmark employment tribunal ruling that Uber's drivers should be classified as workers to enjoy basic rights of workers such as minimum wage, holiday pay, and pensions.[10] The ruling plays a significant role in transforming the UK's gig economy by protecting drivers who might be exploited by algorithm which forces them to work long hours at low pay.

Moreover, the UK investors seem to be more conservative than their American and Asian peers in terms of their attitudes towards the public companies with DCS. In the Deliveroo's case, whilst Class A shares (one vote per share) have been issued to public investors, Class B shares (20 votes per share) have been allotted to Mr Will Shu who is the co-founder; despite that Mr Shu owning merely 6.3 per cent of its shares, he is able to tightly control the business by exercising 57.5 per cent of entire voting rights, thanks to the DCS.[11] Thus, Deliveroo has been facing backlashes at a time when the concept of "Environmental, Social, and Governance" (ESG) has been embedded into the investment decision-making process of some of the largest UK investment houses. During the COVID-19 pandemic, institutional investors tend to focus more on the workers' rights and welfare, and they have been applying non-financial criteria in analysing business risks and growth opportunities. An increasing number of mutual funds, hedge funds, and robo-advisers have been devising new investment products compatible with the ESG standards which are labelled as the sustainable or socially responsible investing methodology.

From this perspective, Deliveroo's business model is not entirely ESG-compatible for two reasons. First, in terms of the "Social (S)" criteria which considers the business relationship with suppliers, employees, customers, and the communities where the company operates, Deliveroo is criticised for not providing good enough working conditions regarding employees' health and safety. Secondly, as for the "Governance (G)" standard, it assesses the company's leadership, executive pay, internal controls, auditing, and shareholder rights. Clearly, the use of DCS is against the ESG in a sense that many shareholders have been deprived of their rights in deciding important corporate issues due to the reduced voting powers. Therefore, it is expected that Deliveroo will continue to encounter protests and criticisms over its treatment of riders as well as its utilisation of DCS for the upcoming years. When reforming the corporate listing rules to build a more efficient, competitive, and attractive capital market, the UK government and financial regulators have to carefully balance the goals of encouraging the tech innovation and entrepreneurship on the one hand, and achieving the socially responsible corporate culture on the other.

[7] Jordan Novet, "Zoom Rocketed 72 Per Cent on First Day of Trading", CNBC (18 April 2019), *https://www.cnbc.com/2019/04/18/zoom-ipo-stock-begins-trading-on-nasdaq.html* [Accessed 13 July 2021].
[8] Tim Bradshaw and Attracta Mooney, "Disaster Strikes as Deliveroo Becomes 'Worst IPO in London's History'", *Financial Times*, 1 April 2021, *https://www.ft.com/content/bdf6ac6b-46b5-4f7a-90db-291d7fd2898d* [Accessed13 July 2021].
[9] Jasper Jolly and Joanna Partridge, "Top UK Fund Refuses to Invest in Deliveroo Amid City Concern Over Riders' Rights", *The Guardian*, 24 March 2021, *https://www.theguardian.com/uk-news/2021/mar/24/top-uk-fund-refuses-to-invest-in-deliveroo-amid-concern-over-riders-rights* [Accessed 13 July 2021].
[10] *Uber BV v Aslam* [2021] UKSC 5; [2021] I.C.R. 657.
[11] Deliveroo, "IPO Prospectus (2021)", *https://corporate.deliveroo.co.uk/protected_file/175/* [Accessed 13 July 2021].