CHARTA LEARNING · LESSON NOTES

Share classes, jurisdictions and the voting process

CFA Level I · Equity Investments

You will learn: Separate the economic and control rights of a share, compute economic and voting shares across classes, order the claims of preference and ordinary shares, and follow and count a shareholder vote, including cumulative voting.

Running example: Examples follow a made-up company, Kestrel Media (millions of shares): Class A (public) 100 with 1 vote each, Class B (founders) 25 with 10 votes each, both ordinary with the same dividend claim, and 2 preference shares with a fixed dividend and usually no vote.

1. Two kinds of right, and dual class shares

- A share carries economic rights (the claim on dividends and on the residual claim, what is left if the company is wound up after lenders and others are paid) and control rights (mainly the vote, to help choose the board and approve big decisions).
- By default one ordinary share carries an equal slice of both. Money claim follows what you paid; the say can be set apart by share class.
- To count votes, multiply the shares in each class by the votes per share and add up. Under one share, one vote, economic share and voting share are the same; with unequal votes they separate. Always compute both.
- For an outside investor in a dual class structure you are buying cash flows with very little say over how they are produced. Expect a discount for giving up control.

> **Economic share = shares held ÷ shares in issue; Voting share = votes held ÷ total votes**

KESTREL (EXAMPLES 1 AND 2)

Founders' economic share	25 ÷ 125	**20%**
Class B votes; total votes	25 × 10; 100 + 250	**250m; 350m**
Founders' voting share	250 ÷ 350	**71.4% (public 28.6% of votes, 80% of the money)**
Founders sell x of Class B (converting to Class A): keep control while	10(25 − x) > 100 + x	**x < 13.64m (150 ÷ 11)**
Lowest economic stake that still controls	(25 − 13.64) ÷ 125	**9.1%, one in 11 (1 ÷ (10 + 1))**

Watch out: Assuming voting share equals economic share; thinking a high vote share means a bigger dividend (dividends are paid per share).

2. Preference shares: priority instead of a vote

- Preference (preferred) shares usually give up the vote in return for priority: a fixed dividend paid before any ordinary dividend, and repayment of a stated amount first in a wind-up. A hybrid, part bond, part share.
- Cumulative: missed dividends carry forward and must be paid in full before ordinary holders get anything. Non-cumulative: they are lost. Participating: can share in extra profit. Convertible: can be swapped for ordinary shares.
- Typical rights: Class A ordinary, 1 vote, residual claim. Class B ordinary, 10 votes, same residual claim. Preference, no vote, fixed, first. Non-voting ordinary, no vote, full residual claim. When a share has fewer votes, ask what it received in exchange.
- Class B receives the same dividend and wind-up cash per share as Class A, despite ten votes.

KESTREL DIVIDENDS AND WIND-UP (EXAMPLES 3 TO 5; PREFERENCE $3 FIXED DIVIDEND, $25 LIQUIDATION PREFERENCE)

Dividend pool $56m: preference first	2m × $3	**$6m**
Per ordinary share (125m)	(56 − 6) ÷ 125	**$0.40 (founders $10m, public $40m)**
Weak year ($4m), then $20m. Cumulative: ordinary per share	(20 − 6 − 2) ÷ 125	**$0.096 (preference gets $8m)**
Non-cumulative: ordinary per share	(20 − 6) ÷ 125	**$0.112**
Wind-up, $300m left: preference claim; per ordinary share	2m × $25 = $50m; 250 ÷ 125	**$2.00**
Bad case, only $40m left	preference takes all	**$20 a share, ordinary nothing**

Watch out: Forgetting that preference shares usually have no vote but are paid first, and that missed cumulative dividends build up.

3. Jurisdictions and sunset clauses

- A jurisdiction is the country or market whose law and listing rules apply. On a line from control follows money to control can be separated: one share, one vote; vote ratio capped (say ten to one); dual class with a sunset clause; few limits.
- The labels describe types of rule, not countries, and rules change often.
- What differs: whether unequal-vote classes are allowed and by how much; whether non-voting or restricted-voting shares can be listed; the voting method for directors; and the majority needed. Ordinary resolutions usually need a simple majority; special resolutions (such as changing the constitution) need two thirds or three quarters.
- Index providers and investors have their own views; some shun dual class companies. Always check the local rule.
- A sunset clause makes extra votes expire on a trigger: a fixed date (say seven years after listing) or an event (founders' stake below a set level, or a founder leaving). Class B then converts one for one into Class A.

SUNSET CLAUSE AT KESTREL (MADE-UP TERMS)

At listing: founders' share of votes		**71.4%**
After the trigger: B converts to A	25 ÷ 125	**20% of votes, equal to the economic share**

Watch out: Treating a label as a guarantee: Class A may be the high-vote class in one company and the low-vote class in another. Read the terms.

4. The voting process and counting votes

- A proxy is a vote cast in advance, or by someone you authorise, so most votes are in before the meeting. Management drafts the agenda; the board is elected, oversees management and recommends a vote; proxy papers go out.
- Asset owners (such as pension funds) usually hand voting to the asset manager unless the mandate kept it; proxy advisers sell research and recommendations but own no shares and do not vote.
- A quorum is the minimum represented for a valid meeting. Abstentions usually are not votes for or against. An ordinary resolution passes with more than half the votes cast; a special resolution needs a bigger majority. Count votes, not shares, when classes differ. Turnout is quoted in shares.
- Proxy advisers help managers who hold thousands of companies, but votes may follow a generic policy and one firm's view can move many votes; managers remain responsible. A binding vote must be acted on; an advisory vote (many pay votes) is a signal.

Support = votes for ÷ (votes for + votes against); Turnout = shares voted ÷ shares in issue

KESTREL PAY PLAN (EXAMPLES 6 AND 7, VOTES IN MILLIONS; CLASS A: 25 FOR, 45 AGAINST; ALL CLASS B FOR)

Votes for; votes against	25 + 250; 45	**275; 45**
Support	275 ÷ 320	**85.9% (passes)**
Public (Class A) support	25 ÷ 70	**35.7%**
Turnout by shares	95 ÷ 125	**76%**
30 of the 45 against followed the adviser	30 ÷ 45	**66.7%**
Had the adviser said for: Class A support	(25 + 30) ÷ 70	**78.6%; Class B still decides**

Watch out: Counting shares instead of votes; putting abstentions or unvoted shares into support; thinking advisers cast votes; assuming every vote is binding or that a passed vote means everyone agreed.

5. Cumulative voting

- With statutory voting each board seat is a separate vote, every share gets one vote per seat, and a majority holder can win every seat.
- With cumulative voting a shareholder gets one vote per share for each seat being filled and may put them all on one candidate. This helps minority holders win representation and caps how many seats a majority can sweep.
- Shares needed to elect k directors: k times the shares voting, divided by the seats up plus one, plus one extra share.

Shares needed = k × N ÷ (S + 1) + 1

THREE SEATS, 1,000 SHARES VOTE: MAJORITY 700, MINORITY 300 (EXAMPLE 8)

Statutory voting	700 beats 300 at every seat	**3 to 0**
Minority votes on one candidate	300 × 3	**900**
Majority votes, spread over 3 candidates	700 × 3 = 2,100; ÷ 3	**700 each, so the minority wins a seat (2 to 1)**
Shares needed for one seat	1,000 ÷ 4 + 1	**251**

Key takeaways

- A share has economic rights and control rights; classes can separate them, so a fifth of the money can hold most of the votes.
- Compute economic share and voting share separately; count votes, not shares.
- Preference shares trade the vote for priority; cumulative arrears must be paid before ordinary dividends.
- Dividends and wind-up cash follow shares, not votes.
- Support = for ÷ (for + against), excluding abstentions; turnout = shares voted ÷ shares in issue.
- Cumulative voting needs k × N ÷ (S + 1) + 1 shares to win k seats.

Quick check

1. Class A 80m, 1 vote. Class B 20m, 5 votes. Class B's share of votes?
   Answer: 100 ÷ 180 = 55.6%, with 20% of the money.
2. Cumulative preference, $2 × 1m shares, nothing paid last year. Owed first?
   Answer: 2m + 2m = $4m before any ordinary dividend.
3. 600 shares vote, 4 seats, cumulative. Shares to guarantee one seat?
   Answer: 600 ÷ 5 + 1 = 121 shares.

Summary notes for the Charta whiteboard lesson. Examples use made-up figures. Watch the full lesson at charta-learning.com.