FINANCIAL TIMES

April 19, 2015 7:23 pm

A cautionary tale of power, votes and second-class shares

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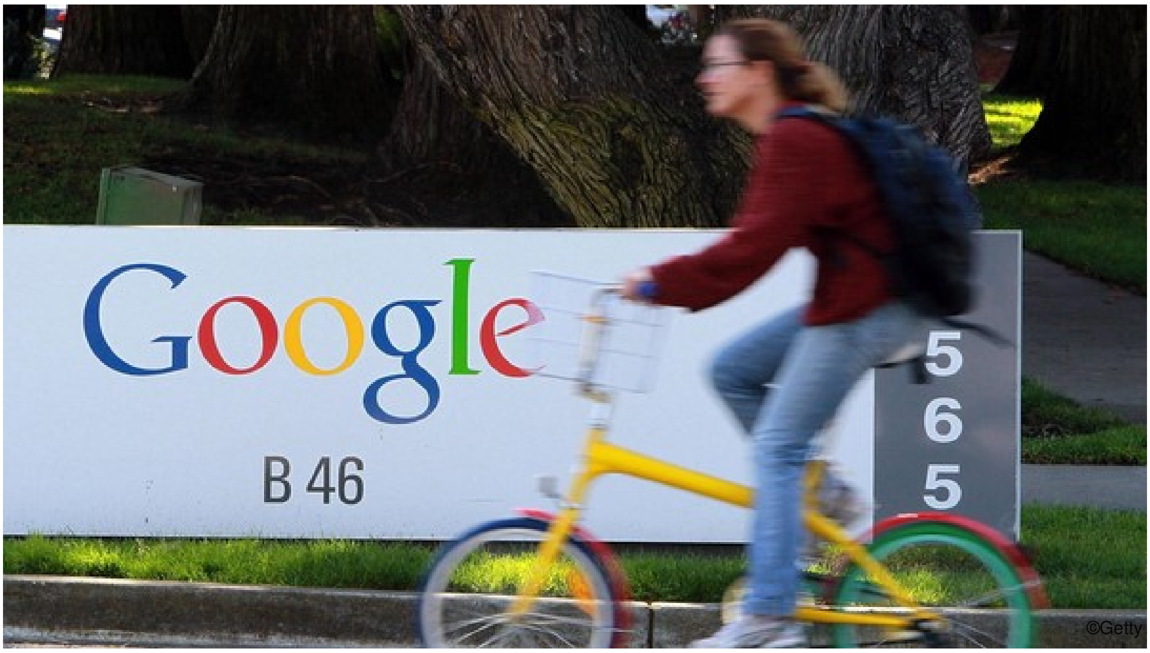
The value of a company must be shared with all, writes Christopher Rossbach



Google, was one of the first in Silicon Valley to issue second-class shares

Four years into the downturn that followed the dotcom boom, two computer scientists greeted Wall Street with a brazen offer that was to make them and their investors rich: a stake in a company that would be beyond ordinary shareholders's influence, perhaps for as long as its founders lived.

The company, Google, was one of the first in Silicon Valley to issue second-class shares that give outside investors no say. Its success is one reason why such “dual-class” structures — once synonymous with the clubby boardrooms and chancy capital markets of the continental Europe of lore — have won wide if sometimes grudging acceptance from investors. We are shareholders ourselves. Yet unseemly events unfolding at a much older Swiss company, in which we also own shares, offer a lesson to investors about the importance of having a vote and knowing their rights.

Sika began in 1910 when Kaspar Winkler also developed a new technology: a compound that let him waterproof the damp tunnels beneath the Alps so electric trains could pass through them. The particular skill of Winkler and his successors was to find sons-in-law who could carry on the business. They did so twice: in 1921 when Friedrich Schenker joined after marrying Winkler's daughter; and in 1953 when Romuald Burkard entered after marrying Schenker's daughter Franziska.

The family owns only 16 per cent of Sika; in an ordinary public company its scions would long ago have been removed by investors, probably to the company's detriment. Shareholders' impatience for a quick jump in the share price is one reason why many boards take on too much debt, make expensive acquisitions or sap long-term value by chasing short-term profits.

But Sika was no ordinary company. Despite their fairly small economic interest the Winklers (and later the Schenkers and Burkards) had 52 per cent of the votes. That is because they own a special class of shares which,
like those held by Google's founders,do not trade on the stock exchange.

Unchecked power poses risks, as we knew when we became shareholders in 2004. But we believed the Burkards when they said they would treat shareholders fairly, as they had for generations. We also did our work to understand the rights of minority shareholders, who between them have a majority of the shares but not of the votes. Since then Sika's earnings have quadrupled and its share price has risen sixfold. Such successes explain why founder-controlled companies are among Europe's best-performing stocks.

But when Franziska Burkard-Schenker died in 2013, 10 years or so after her husband, something changed. Within a year their heirs decided to sell; Saint Gobain, a French maker of construction materials, agreed to pay an 80 per cent premium to buy the family's controlling stake. Other shareholders did not even get an offer. Our shares lost close to one-fifth of their value that day.

To us, this violates an elementary principle of fairness that was a critical consideration for our investment in Sika: that, while control may be concentrated in the hands of a few shareholders, the value of the company must be shared with all. The dual-class structures used in Silicon Valley improve on the European model in a way that clearly respects this rule. Google's super-shares possess special powers only in the hands of the founders; once passed on, they carry the same weight as ordinary shares. Facebook's do, too.

Sika shareholders do not enjoy the same protection, but we know our rights, and — led by Bill Gates, another long-term shareholder — we are standing up for them. The Swiss establishment is rallying behind the company's chairman and a majority of its directors, who are trying to block the family's sale.

Even if their principled stand ultimately succeeds, as I believe it will, this ugly episode provides a cautionary tale about the risks of super-voting shares. Yet investors should also be discriminating. Insisting that all shareholders have an equal vote may prevent the abuse of power, but it can stymie those talented and patient entrepreneurs who are intent on repaying investors' trust.

The writer is managing partner at J Stern & Co, a private investment firm

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