Equity Practices at Technology Companies with Multi-Class Stock Structures

In recent years, the number of companies conducting an IPO with a multi-class stock structure has been quite pronounced. For example, in 2018 more than 10% of the companies that conducted an IPO on the U.S. national securities exchanges (15 of 140 companies) had multi-class stock structures. Nearly half (seven) of these 15 companies are in the technology sector and represented 29% of all technology IPOs in 2018.

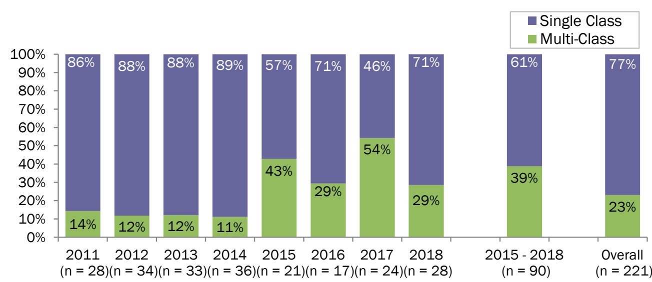
Multi-class stock structures, which have been around since the 1950's, are designed to ensure that a specific group of shareholders, usually the company's founder(s) and senior executives, maintain voting control of the company even though the economic ownership of the entity is spread broadly among all shareholders. Typically, the founder and senior executive shares are entitled to 10 votes each, while the shares of public shareholders are limited to one vote per share.

Such arrangements have generated significant public debate. Opponents argue that multi-class stock structures violate the principle of "one share, one vote" and do not adequately protect the public shareholders. Both the Investor Stewardship Group and the Council of Institutional Investors, advocacy groups with members that oversee almost $50 trillion in assets, have registered their opposition to the practice. Moreover, Institutional Shareholder Services ("ISS") and Glass Lewis & Co., Inc. generally disfavor such arrangements. And, in recent years the S&P Dow Jones and FTSE Russell have begun to exclude some companies with multi-class class structures from their indices. On the other hand, proponents believe that such arrangements free companies from having to manage to near-term (quarterly) financial results, thereby enabling the founders and/or senior executives to carry out their long-term vision for the company.

Increasingly, multi-class stock structures have become common in technology company IPOs. Recently, we reviewed technology sector IPOs from 2011 through 2018 to better understand the design of their multi-class share arrangements, as well as to ascertain whether such entities, as controlled companies, structure or use certain aspects of equity compensation differently from their counterparts with just a single class of stock.

Multi-Class Stock Structure Prevalence

From 2011 through 2018, 23% of the technology companies that conducted an IPO (51 of 221 companies) had a multi-class stock structure. From 2015 through 2018, this trend has increased as 39% of the technology companies that went public provided for a multi-class stock structure (including 54% of technology IPOs in 2017!).

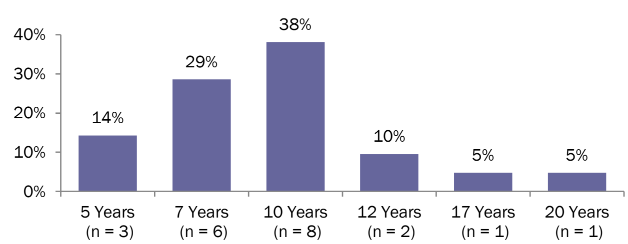


Number of Share Classes

Of the 51 technology companies with multi-class stock structures that we reviewed, 90% provided for two classes of stock – a dual class arrangement. The remaining companies provided for three classes of shares with different voting rights. Further, at 92% of the companies examined, the founders and senior executives received 10 votes per share with the combined voting power of more than 95% on average for the superior class of stock.

Sunset Provisions

For the technology companies with a multi-class stock structure, 41% (21 companies) included a time-based "sunset" provision requiring that, after a specified number of years, the class of stock with the superior voting rights automatically convert into common stock with one vote per share. The most common period before this sunset provision is triggered is 10 years, followed by seven years:



Equity Practices at Technology Companies with Multi-Class Stock Structures (continued)

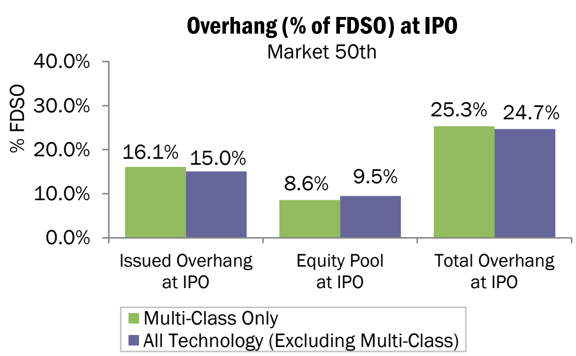
At several technology companies, the sunset provision is also triggered once a specified executive (typically, the founder) is no longer with the company, although the specific details of the trigger vary from company to company. Some are activated only upon death (the most restrictive provision), while others are activated by any departure (the broadest provision). Still, others are activated only for certain types of departures (not including retirement) or if the chief executive officer's stock ownership falls below a specified level.

Equity Compensation Practices at IPO

Although technology companies with a multi-class stock structure have the power, via their voting control, to get post-IPO amendments to their equity compensation plans approved by shareholders, these companies generally adopt an equity compensation plan at the time of their IPO with terms (including the size of their initial share reserve and the presence of an "evergreen" replenishment provision) that are consistent with the practices of the broader technology sector and intended to minimize the need to submit proposals related to the equity plan to shareholders for up to 10 years after the IPO.

Overhang

While the issued and total overhang at IPO of technology companies with a multi-class stock structure[1] were slightly higher at the median than that of broad technology companies, the median size of their equity pool at IPO was comparable (8.6% for multi-class companies compared to 9.5% for broad technology companies):

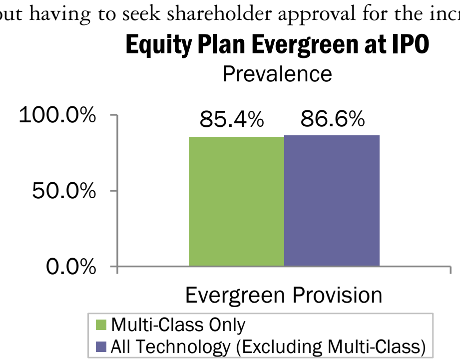


Issued overhang = total stock options and unvested restricted shares / units outstanding divided by fully-diluted shares outstanding

Total overhang = total stock options and unvested restricted shares / units outstanding plus shares available for future grant divided by fully-diluted shares outstanding

Evergreen Provision

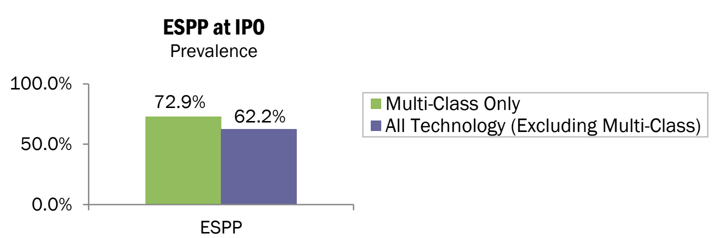
Eighty-five percent of the technology companies with a multi-class stock structure (41 companies) included an "evergreen" replenishment provision in their IPO equity compensation plan compared to approximately 87% of broad technology companies. An "evergreen" provision provides that the board of directors may, in its discretion, add a fixed number of shares to the available share reserve each year following the IPO (commonly for 10 years) without having to seek shareholder approval for the increase.



Further, a majority of the multi-class companies (27 of 41 companies, or 66%) and broad technology companies with an evergreen provision (82 of 142 companies, or 58%) provided for an annual 5% increase in shares under their evergreen provision.

Employee Stock Purchase Plans ("ESPPs")

An ESPP is another tool that technology companies with a multi-class stock structure use to differentiate their compensation offerings from the broader competitive labor market. Such companies tend to be more aggressive with ESPPs, both in terms of prevalence (approximately 73% for multi-class companies compared to approximately 62% for broad technology companies), as well as offering period length (a greater number of multi-class companies tend to have 12 to 24 month offering periods while a majority of broad technology companies tend to use six month offering periods).



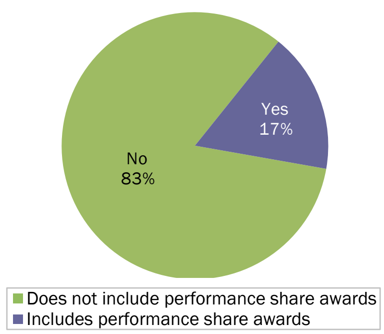
1. The data in this section of the Thoughtful Pay Alert excludes three companies with multi-class stock structures, Blue Apron Holdings, Match Group, and Switch, which, at the time of their IPO, had unusual capitalization or legal structures.

Interestingly, the median size of the ESPP equity pool at IPO for multi-class companies and broad technology companies was essentially the same (1.8%) as was both the prevalence of evergreen provisions (91% at multi-class companies versus 93% at broad technology companies) and the size of the annual increase in shares under such provisions at each percentile ranking (1.0%).

Performance-Based Equity Practices

In today's environment, within one to three years of an IPO, many technology companies have introduced performance-based equity awards (usually restricted stock unit ("RSU") awards) into their long-term incentive compensation program. Typically, the shares subject to these awards may be earned contingent upon the achievement of financial or operational performance measures or stock price-based goals. In fact, in the broad technology sector, approximately 60% of companies use performance-based RSU awards.

In our experience, however, the use of performance-based equity awards is less common, or can be significantly delayed following IPO, at companies with a multi-class stock structure. While the absence of performance-based equity can be a qualitative factor that may leave a company vulnerable to a failed Say-on-Pay vote or a substantial withhold vote for the re-election of directors serving on the compensation committee, companies with a multi-class stock structure may have less concern about these issues since they are virtually assured of passing Say-on-Pay and re-electing their director slate.



As a result, of the technology companies with a multi-class stock structure that we reviewed that had filed their initial proxy statement since their IPO (41 companies), only seven (17%) have included performance share awards as part of the equity mix for their executive officers following their IPO. This is consistent with what we have seen at mature public technology companies with multi-class stock structures (or companies with majority insider ownership), such as Google.

Conclusion

In spite of the associated controversy, multi-class stock structures continue to grow in popularity among technology companies. Perhaps to ensure ongoing compensation program flexibility and to maintain advantages in the competitive labor market, such companies tend, for the most part, to manage their equity compensation programs in a manner consistent with, or even more aggressive than, that of their counterparts with a single-class share structure.

About Compensia:

Compensia, Inc. is a management consulting firm that provides executive compensation advisory services to Compensation Committees and senior management.■

Exhibit A

Technology Companies with Multi-Class Stock Structures that Conducted an IPO from 2011 - 2018		
Altair Engineering	GoPro	Smartsheet
Alteryx	Groupon	Snap
AppFolio	Inovalon Holdings	Square
Appian	Kayak Software	Stitch Fix
Apptio	LinkedIn	Switch
Bandwidth	Match Group	Tableau Software
Bloom Energy	MINDBODY	The Trade Desk
Blue Apron Holdings	MongoDB	Twilio
Box	Mulesoft	Veeva Systems
CarGurus	Nutanix	Wayfair
Castlight Health	Okta	Workday
Domo	Pivotal Software	Workiva
Dropbox	Pluralsight	Yelp
Eventbrite	Pure Storage	Zillow
Facebook	Ringcentral	zulily
Fitbit	Roku	Zuora
GoDaddy	SecureWorks	Zynga
Post-2018		
Fastly		
Lyft		
Pinterest		
SciPlay		
Zoom Video Communications		

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