

The impact of dual-class share structure on corporate governance—Take Xiaomi Corporation as an example

Bian Zimiao

School of Management Engineering and Business, Hebei University of Engineering, 056000, Handan, Hebei, China

Abstract: *The dual-class share structure was introduced to China relatively late, and there is a lack of relevant research. Meanwhile, corporate governance is an essential part of the high-quality development of listed companies, and the effectiveness of corporate governance is an important evaluation method for the long-term and stable development of enterprises in the future. Therefore, studying the impact of the dual-class share structure on corporate governance has profound significance for both enterprises and the Chinese capital market. As the first company to go public in Hong Kong with a dual-class share structure, Xiaomi, through analyzing the impact of the dual-class share structure on its corporate governance, identifies the corporate governance risks faced by Xiaomi after adopting the dual-class share structure and proposes suggestions to address these issues, with the aim of providing inspiration for the equity structure transformation of other companies and promoting the reform process of China's equity structure.*

Keywords: *Dual-class share structure; Corporate governance; Xiaomi Corporation*

1. Introduction

Compared with the traditional "one share, one vote", the dual ownership structure helps the founder's control not be diluted. Because the dual ownership structure can make the founding team occupy the highest share of voting shares, and then obtain the absolute control of the company. In this way, the company can raise enough money and keep the founder in control of the company. Therefore, the dual ownership structure is also an important weapon for many listed companies to resist malicious attacks. In the face of the emergence of high-quality start-ups, founders increasingly need to control the company. China restarted the pilot work of the dual ownership structure system in 2018, and the first company to successfully apply for listing was Xiaomi company, which applied for listing on the Hong Kong Stock Exchange on May 3 and officially listed in Hong Kong on July 9. Xiaomi company is the dual equity structure company with the shortest establishment time and the first dual equity structure company listed on the Hong Kong stock exchange. It is representative in the Internet industry. A detailed study of the changes in corporate governance before and after its listing can provide reference for other companies with shorter establishment time and faster development in the establishment of equity structure. By analyzing the motivation and risks of Xiaomi's choice of dual ownership structure listing and putting forward suggestions, this paper can provide practical guidance for China to reasonably promote the dual ownership structure system.

2. Literature Review

Zhang Yingzhi (2020)^[1] et al. proposed that the dual-class share structure can meet the different needs of different shareholders and improve the efficiency of corporate management and decision-making. Bi Yanjie (2024)^[2] et al. argued that because the dual-class share structure can ensure the control of the company by the founding team, it can enhance their sense of responsibility and self-discipline towards the enterprise. Wang Shuting (2021)^[3] et al. pointed out that due to the highly concentrated control in the hands of the founders, other shareholders cannot express their opinions through their shares, and the supervision system fails. Since the consent of the founders is required for acquisition, external supervision also fails. In addition to the above disadvantages, Du Yuan (2023)^[4] proposed that the dual-class share structure has low transparency in information disclosure and provides opportunities for major shareholders to erode the interests of minority shareholders. Li Meiyin (2023)^[5] et al. pointed out that the dual-class share structure requires founders to balance their control

rights, the long-term development of the company, and the rights of common shareholders, which poses challenges to corporate governance. Facing the challenges brought by the dual-class share structure, Qiu Kai (2024)^[6] et al. believe that the first step is to improve the transparency of information disclosure, while Zhang Tao (2024)^[7] et al. believe that timely disclosure of matters that may affect the interests of common shareholders is necessary to protect investors' interests. Secondly, it is necessary to improve the supervision mechanism, optimize the capital structure, and the relevant departments in charge of securities need to protect the interests of small and medium-sized shareholders when accepting the listing of companies with dual-class share structures. Companies also need to enhance the governance level of their managers.

3. Company Profile

Xiaomi Technology Co., Ltd. (referred to as "Xiaomi Corporation" in this article) was established on March 3, 2010, and went public in July 2018 with a dual-class share structure. The company is positioned as an Internet enterprise, with Lei Jun as its founder. At the beginning of its establishment, Xiaomi Corporation chose to avoid direct competition and take a different path, focusing on terminal hardware (mainly mobile phones, as well as routers and TVs) as the core of promotion. Through terminal hardware, it built a unique ecosystem for Xiaomi Corporation and bound its self-developed software products, such as Mi Chat, Xiaomi Browser, and Mobile Manager, etc. Based on this, it effectively connected and communicated with consumers, accumulated core customers, promoted its products, and ultimately formed a complete business cycle.

3.1 Financing Experience

Since its establishment, Xiaomi Corporation has initiated a total of six rounds of financing. In 2010, it launched two rounds of financing. The first round lasted for eight months and was mainly funded by individual investors. The fundraising effect of this round was average, with a total of only about 10 million US dollars raised, which included 3 million US dollars invested by Mr. Lei Jun. Considering the poor outcome of the first round of financing, Xiaomi Corporation began its second round of financing just three months after the first round. This round lasted for nine months and was significantly more successful than the first round, raising approximately three times the amount, or about 30 million US dollars. In 2011 and 2012, Xiaomi Corporation conducted two more rounds of financing. Among them, the third round began less than a month after the second round ended. This round lasted for six months and raised approximately 90 million US dollars. In 2012, the fourth round of financing was initiated. That year, Xiaomi's smartphone business flourished, with sales exceeding seven figures, leading to a generally optimistic outlook for the company's future development in the capital market. As a result, this round of financing was highly successful, raising over 200 million US dollars, which was the first time the company raised more than 100 million US dollars. As Xiaomi's development prospects became increasingly promising, in the fifth round of financing, the company raised 100 million US dollars in just one day after opening the round. This clearly demonstrated investors' confidence in its future. Considering the future capital needs for development, Xiaomi Corporation deliberately extended the sixth round of financing for a relatively long period - a total of two years and eight months. This round attracted the participation of many capital-rich enterprises. Ultimately, this round raised over 1.1 billion US dollars for Xiaomi Corporation. After these six rounds of financing, Mr. Lei Jun's shareholding ratio dropped from over 40% initially to 31.41% now. Although he remains the largest shareholder of Xiaomi Corporation, if the dual-class share structure is not taken into account and only voting rights are considered, he no longer has sufficient control over the company.

3.2 Ownership structure

In July 2018, Xiaomi company was successfully listed in Hong Kong. Xiaomi company adopted a structure with multiple voting rights. According to this structure, the company's shares can be divided into a shares with higher voting rights and B shares with less voting rights, as shown in Table 1.

Table 1 Ownership structure of Xiaomi company

	Class A shares	class B shares
Voting rights	10 votes	1 vote
Holder	Founding team	Public investors
Circulation mode	Unlisted	Free circulation
Conversion voting rights	In certain cases, it can be converted to class B	Not class A

Data source: prospectus of Xiaomi company

According to the prospectus of Xiaomi company, class A shares have 10 voting rights per share and class B shares have only one voting right per share. Under exceptional circumstances (such as revision of share subordination rights, adjustment of independent non-executive directors, selection, replacement of audit institutions and liquidation and dissolution of the company, etc.), the voting rights of class A shares are reduced to one. Class A shares are held by the founding teams Lei Jun and Lin bin, and are prohibited from listing and circulation; Class B shares are for ordinary shareholders without circulation restrictions. Class B shares cannot be converted into class A shares, while class A shares can be converted into class B shares at a ratio of 1:1 under certain conditions. The company also makes other restrictions on class A equity to protect the interests of class B Shareholders. See Table 2 for details:

Table 2 Restrictions on Class A shares of millet company

Issuance and share requirements	<ol style="list-style-type: none"> 1. The ratio of a shares to the total number of shares shall not be increased in any form; 2. If all a shares of the company are converted into B shares, class A shares in the authorized share capital will be automatically converted into class B shares, and the company will not issue class A shares in the future; 3. The ownership of a shares may not be changed or increased
Exit system	Resignation or exercise of transfer rights by directors holding class A shares

4 .Motivation for Xiaomi to implement dual ownership structure

4.1 Enhancing the value of human capital

Xiaomi uses the Internet of things to attract advertisers to pay dividends, but key information such as the source of profits and how they are obtained is not very clear, making investors confused about it. Secondly, it is difficult for entrepreneurial managers who urgently need financing to accelerate the development of unique business models to obtain sufficient capital support, which can only be achieved by transferring shares. Thus, a pattern of external investors providing financial support and senior managers immersing themselves in business model innovation has been formed, and the win-win situation between the two has been achieved with the help of unique equity design.

4.2 Preventing hostile takeovers by competitors

Xiaomi's class B shares can circulate freely in the capital market, but class A shares with high voting rights are restricted and cannot be traded in the capital market, and most of the voting rights of the company are in the hands of those A-share shareholders. Therefore, even if the capital tycoons buy all class A shares in the stock market, the founders can still control the company by exercising their high voting rights, so that management can focus on the company's operations to enhance corporate value, and do not have to worry about being expelled from the company they founded, reducing the risk of malicious acquisitions.

4.3 Reflecting the demand for shareholder differentiation

Xiaomi is a team of founders of a group of electronics enthusiasts who are high-quality talents chasing entrepreneurial dreams and professional technology, and they will not easily give up control of Xiaomi because they devote a lot of thought, energy and financial resources. Just as a parent is willing to give everything to his children, Lei Jun values the future of Xiaomi more than his profits, and he will not give up the company's long-term development for temporary profits. In short, the most desired return for founders is to be able to control and accompany the company's healthy development. The

design of this special ownership structure gives managers stable control, but also gives founders more confidence to make long-term plans, thus promoting the continuous appreciation of enterprises.

5. Risks of corporate governance under the dual ownership structure of millet company

5.1 Rigid board structure

The main purpose of the founder's dual ownership structure is to continue to control the company's business decisions and development direction. As an important authority of the company, the board of directors can also have an impact on it. After the dual ownership structure listing, Lei Jun and Lin Bin's rights in the board of directors reached their peak. Among the seven member board of directors, only Lei Jun and Lin bin have two executive directors, with resolution power and executive power. The remaining five directors are non-executive directors, who only have the right to propose proposals and provide opinions and judgments for the board of directors. So the founder has more influence on the board. According to the articles of association of Xiaomi company, new directors need to be nominated by the nomination committee. After the board of directors votes and approves them, they shall be voted by shareholders at the shareholders'meeting. Persons who have not been elected by the board of directors may not be elected as shareholders at any shareholders'meeting. If a director resigns temporarily, the Board shall have the power at any time to appoint any person to be an interim director to fill a casual vacancy. Each director shall retire from office at least once every three years, and eligible shareholders may be re elected for re-election. Lei Jun and Lin bin can exercise special voting rights when electing board members other than independent directors, that is to say, if the board of directors nominates board members who are not the members Lei Jun and Lin bin want, they can use their voting rights to veto directly, and the temporary directors will continue to serve until the desired members are elected. In addition, the articles of association stipulate that when the beneficiary of Xiaomi's special voting rights no longer serves as a member of the company's board of directors, a shares will be automatically converted to B shares, which also shows that Lei Jun and Lin bin will always hold positions on the board of directors if they do not want to give up their special voting rights. In addition to independent directors, the two board members will also make decisions more inclined to Lei Jun and Lin bin. From the above mechanism, we can see that Lei Jun and Lin bin have greatly affected the appointment and removal of board members through the voting rights of directors elected at the shareholders'meeting of millet company, and consolidated the position of Lei Jun and Lin bin in the board of directors. But it also raises the issue that board members are dominated by Lei Jun and Lin bin, and decisions are made solely by Lei Jun and Lin bin, which will lead to a rigid board structure.

5.2 Weak regulatory oversight

After Xiaomi's listing, a governance committee was established on the Hong Kong stock exchange to examine whether the company violated the listing rules and maintained a dual equity structure. However, the scope of supervision of the Governance Committee is not substantially different from that of companies with the same shares and rights. The members of the Governance Committee are independent directors and overlap with other committee members, which has many adverse effects. On the one hand, members also serve as members of the nomination committee, which is prone to self supervision; On the other hand, independent directors do not participate in the daily activities of the company, and the channels to obtain internal information are limited and easy to be whitewashed by management. In addition, Wang Shunde, an independent director, has a close relationship with Lei Jun, which may reduce supervision. There are some defects in the company's regulatory system.

5.3 Minority shareholders bear more corporate risks

Under the dual ownership structure, the company's control and income rights are divided, and a small number of shareholders occupy the vast majority of voting rights only by holding fewer shares, thus realizing effective control of the company, while on the contrary, the small and medium-sized shareholders who hold more shares generally have little say. Therefore, in this case, if the minority controlling shareholders cause huge losses to the enterprise due to their own wrong business behavior, they only need to bear responsibility according to the shares they hold, and most of the company's losses should be borne by external investors who hold more shares, that is, bear more risks, which will inevitably cause some damage to those minority shareholders who have no voice. In addition, when there is a contradiction between the interests of controlling shareholders and other shareholders,

because the former has the final say on major matters of the company, external investors often have no right to make resolutions on major matters, and their rights claims can not be basically guaranteed.

6. Advice

6.1 Improve the withdrawal mechanism of special voting rights

Set time based sunset clauses or performance based sunset clauses to exert certain pressure on holders. First, the time-based sunset clause. According to the company's development cycle, the implementation time of the dual equity structure is limited to 8-10 years. After the expiration of the contract, other shareholders can vote on whether to continue to postpone or cancel the dual equity structure system through the resolution of the shareholders' meeting. Secondly, with the continuation of time, the enthusiasm of beneficiaries of special voting rights will inevitably decline, which will violate the original intention of promoting the long-term development of the company by setting up a dual equity structure in the long run. Therefore, by formulating long-term performance indicators and giving special voting rights some supervision and pressure, we can effectively prevent moral hazard and safeguard the interests of minority shareholders.

6.2 Supervisors and independent directors jointly assume regulatory responsibilities

The introduction of independent director system is the main measure to make up for the weak supervision of the board of supervisors of the company, but China's independent directors still have the problems of limited energy, weak independence and limited access to information, and the results of supervision of the company only by independent directors are not necessarily ideal. The dual equity structure also requires favorable supervision to maintain the effectiveness of the mechanism. Therefore, when the company adopts the dual equity structure for listing, it is necessary to introduce independent directors, but also to add supervisor seats to the Governance Committee, rationally allocate the company's regulatory resources and functions, refine the work content, and effectively supervise the rights of beneficiaries of special voting rights

6.3 Establish a sound information disclosure mechanism

In dual ownership companies, minority shareholders are excluded from the decision-making circle, and the founder's power reaches its peak, which will reduce the founder's willingness to disclose the company's internal information. If the company can not fully and systematically disclose the company's internal information, external shareholders will not be able to obtain the real operation of their assets. In the long run, it will not only attack the enthusiasm of external shareholders, but also make the founders lazy and relaxed. Therefore, the company with dual equity structure can not only disclose each issue of financial statements on financial websites, but also hold regular press conferences or open online inquiry services, announce major decision-making matters of the company, answer inquiries from the public and owners on company matters, and strengthen the supervision of the news media and the public on the behavior of founders.

7. Conclusion

Dual ownership structure provides new ideas for the financing of China's science and technology innovation companies. Starting from the recognition of dual ownership structure by the Hong Kong Stock Exchange in 2018, dual ownership structure will be further popularized in China's science and technology innovation companies. In the future, the scale of research on the governance effect of China's dual ownership structure will be further enhanced, and the research will shift from case based to quantitative analysis. It is expected that the research on dual ownership structure will be further refined and efficient.

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