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More Equal than Others: Dual-Class Shares and their future

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INTRODUCTION

More equal than others? Yes, indeed, dual-class shares seems to be offering a miracle – own a modest part of a total amount of shares, but get most of the voting power, which means - control of a company. Dual-class stock principle usually works like this – all stock is divided into two (or more) classes – class A and class B. Class A are usually “the ordinary ones”, which means one share = one vote and are publicly traded. However, class B shares are non-traded and carry ten (number may vary) votes instead of one. There is a possibility of having a third class – non-voting shares too. Most commonly, the founders of the company or other insiders are the owners of this preferred stock.

This controversial corporate governance structure have a lot of critics, who claim, that dual-class shares create unfairness, as the ones with voting power are actually passing the financial risk onto others. But the world is not just black and white. That is why one of our goals in this thesis will be to explain how dual-class shares’ mechanism actually works and provide the reader with all relevant information about its advantages and disadvantages.

Even though dual-class shares had been in the market for a long time, but only during the last decade it caught so much attention. We can thank for that to such well-known “hot” technology companies as Facebook, Google and Zynga. All of these giants adopted dual (or triple) class structure and received both – positive and negative comments on that. In this thesis, we are going to go through all three companies mentioned, carefully analyzing their road to becoming public, corporate structure chosen and the inside culture. This analysis will hopefully provide us with a more clear view of what kind of effects dual-class structure could have on company’s performance. It should also help us decide whether such corporate governance structure can be seen as the new model of “good governance”, or maybe encourage rejecting such term at all. Even though dual-class shares were never “loved” by the society, who criticized it for promoting inequality among investors and encouraging the abuse of power by the controlling shareholder[1], the situation now got even worse.

Shareholder activism became as fierce as never before. Recently, we had seen the growing number of activists, who are not afraid to intervene in case the company is not performing as well as it could be. And by “intervening” I mean not the old fashioned way of

[1] Controlling shareholder here means the one with the greatest voting power.

simply selling their shares, but proposing resolutions, engaging in the discussions with the management or the Board of Directors, calling the General Meeting and so on. The idea now - instead of selling the shares and abandoning the company - is to actually do something and try fixing the problems that have to be fixed. As time passed, the traditional example of a company with many dispersed individual shareholders had changed and now the leading role belongs to institutional investors. These powerful and rich pension funds, banks, investment advisors and so on are becoming more influential every day. As an example we will take CalPERS (The California Public Employees' Retirement System), the largest US public pension fund well known for its corporate-governance campaigns, which called the two-tier system "a corruption of the governance structure" stating that "power should reflect capital at risk". CalPERS argues that dual-class shares destroys shareholder value and promises to boycott companies that have this structure. To make things worse, the pension fund is not the only warrior in the battle against unequal voting rights. Council of Institutional Investors (CII) and Institutional Shareholder Services (ISS) had expressed strong opposition against the existence of dual-class shares too. We will try to find out if there is a threat that other investors could follow their example and ignore companies with unequal voting rights, which would result in their disappearance.

On one hand, shareholder activism looks like a good thing for the companies and even some studies show that the value of the company tends to increase when activists get involved. However, we will try to look at it from a different perspective too and discuss ways how activism can be harmful and lead to the short-term focus. As we can see, the stock prices of the companies, which have dual-class structure, do not seem to be very affected by such strong critics they receive. Investors are still willing to give their money fully knowing, that there is not a slightest chance to gain any control or a say about the governance in such a company. That is why we will raise another question about the real motives of the shareholders nowadays. Why shareholders are willing to invest into what critics say is "bad governed" company? Do they care really about the company, or just short-term returns?

Indeed, the interest in dual-class companies had noticeably grown. That is why this thesis will try to find out if that happened because of changed standards of "good corporate governance", or maybe something else?

To be more specific, this paper will try to find the answers to the following questions.

Research question: Can dual-class shares' structure be called the new "best corporate governance" example, or we are about to see the "death" of it?

Sub questions:

- What dual-class shares are?
- Advantages and disadvantages of dual-class stock?
- Is dual-class of shares structure less likely to protect minority shareholders?
- Are investors seeking to get more involved in company's corporate governance, or the opposite?

CHAPTER I

Dual-class stock and corporate governance

In order to understand dual-class stock structure we will first provide the reader with the explanation about the traditional “one share-one vote” principle. Only after familiarizing with this standard model we will move on and discuss the mechanism of dual-class stock and all the criticism and support it receives from various sources. Further, we will take a look at the minority shareholders’ protection in dual-class companies and argue the idea of shareholders being the owners of the company. Finally, we will end this chapter looking at dual-class companies’ performance in the long-term and short-term run.

1.1. “One share-one vote” principle

Once a private company decides to do the initial public offering (IPO), it issues securities, which are listed on a public exchange. Company’s shares give its holder rights to receive firm’s earnings and empower him to participate in company’s corporate governance by voting - these are the most important rights shareholders can have[2]. “One share-one vote” mechanism is based on the idea, that the voting power should be proportional to economic interest and the ones who have the majority of shares can determine the board of directors and decide upon the major corporate issues. Management team then works under the supervision of board of directors, which is accountable to company’s shareholders. This structure gives incentives for the shareholders to supervise management and maximize firm’s value as it will also increase their earnings[3]. “Corporate law scholars generally accept the "one share, one vote" standard as the basis for efficient distribution of the corporation's voting rights”[4]. “One share-one vote” principle is usually justified by two arguments – 1) shareholders have the biggest incentives to maximize firm value; 2) shareholder’ voting rights should be matched with his economic interest.[5] According to a well-known professor Adolph A. Berle, the basic purpose of

[2] (Rafael La Porta, 1997)
[3] (Grant M, 2008)
[4] Ibid. (quoting Shaun Martin & Frank Partnoy, Encumbered Shares, 2005 U. ILL. L. REV. 775, 777 (2005)
[5] (M. Burkart, 2007)

every corporation is shareholder interests' protection[6]. It had been a common practice for years to claim that shareholders are "the owners" of the corporation and that primal goal of every company should be the maximization of shareholder value.[7] If we would rely on this theory, then "one share-one vote" principle could be easily explained. Managers run the company on the behalf of the shareholders. However, manager's interests might not be aligned with shareholders' and he could seek to get private benefits from the company, instead of working for the best interest of "the owners". This is a so called "principal-agent problem", or "agency problem" in short. Theoretically, shareholders can solve it by monitoring manager's activity or giving him incentives to work well, for example, by offering him stock options. The most important "weapon" here is shareholders' right to overrule manager's decisions in case they disagree with his policy. This is the power that voting rights provide[8]. More shares investor own – more cash flow AND voting rights he gets. "One share-one vote" empowers the shareholders to change or at least influence manager's decisions, as they have a possibility to vote him out of a company in case his managerial skills do not satisfy the investors[9]. "One share-one vote" principle has been taken not only as a legal, but also as a market standard[10].

But what happens in case we separate cash flow and voting rights?

1.2. The mechanism of dual-class stock and its criticism/support

The separation of voting and cash flow rights can be achieved using different techniques – dual stock, pyramids, irrevocable proxies etc.[11], however in this thesis I will concentrate on dual-class stock only. Even though "one share-one vote" standard was long believed to illustrate fairness in corporate voting, but as companies grew bigger – there had been more deviations from "one share-one vote" rule visible.[12]

A company can adopt dual-class structure by its IPO or recapitalization[13]. Companies, which use dual-class stock is not a new trend and have been in the market for years already. Dual-class structure has some variations. In some instances, the superior class allows multiple

[6] (Rutkow, 2011)
[7] (Stout, 2010)
[8] (M. Burkart, 2007)
[9] Ibid.
[10] (Ranade, 2013)
[11] Ibid.
[12] Ibid.
[13] (Chun-Keung Hoi, 2010)

votes per share; or the superior class carries only one vote per share, but the ordinary shares are non-voting. Also, there are restricted-voting structures which empower superior-class shareholder to elect a certain number of board members[14]. Most commonly, dual-class stock is divided in two types of shares[15] – class A and class B. Class A are usually "the ordinary ones", which means one share = one vote and are publicly traded. However, class B shares are non-traded and carry ten (number may vary) votes instead of one. Usually, the founders or other insiders of the company are the owners of this "superior" class of stock. Companies controlled by families, or famous and well-known leaders are the ones, which usually use this structure. Dual-class shares are designed to create the difference between voting and cash flow rights, allowing the insiders of a company to retain control, while having comparatively small amount of total stock. This is very favorable for the owners, who can achieve two of its goals – get the needed financing and maintain the control over the company as they are the ones who matter the most. What are the reasons of the decision to adopt dual-class stock? Basically there are two competing opinions: the ones who negatively look at the existence of superior class of shares claim that owners simply want to maintain control and seek private benefits of control.[16] The supporters of dual stock suggest that dual stock structure is the best protection from hostile takeovers[17], hence, helps the company to concentrate on the long-term results rather than short-term gains[18]. Study[19] had shown that the industry, age and stock-return volatility have significant influence in choosing dual-class shares scheme. The same source had revealed that media industries and start-ups are more likely to adopt the dual-class stock structure, while the size of a firm is not influential at all. "However, the data do appear highly consistent with the hypothesis that agency problems or concerns about expropriation in highly volatile firms make it difficult to sell inferior voting common stock to outsiders in these environments."[20]

We already spoke about agency problem between shareholders and managers, while analyzing "one share-one vote" structure. We also mentioned that it could be at least theoretically solved via monitoring function that shareholders usually execute indirectly by

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[14] (Gry, 2005)
[15] Some companies, as we will see later, have more than two types of shares, but in this paper I will refer to those multi-class firms as "dual-class" too.
[16] (Zhang, 2007)
[17] (Mamudi, 2012)
[18] (Orsagh, 2014)
[19] (Zhang, 2007)
[20] Ibid.

voting. We also said that giving a manager more equity rights would help to incentivize him to perform better. However, in reality it does not always work that way. Shareholders of large companies with dispersed ownership “do not exercise their control rights on a day-to-day basis but delegate it to the board and the management”[21]. It had been also noticed, that dispersed shareholders are not willing to collect necessary information and supervise the management, which results in management’s considerable discretion while running a company that might be abused to get personal benefits[22]. The logical solution for manager-shareholder conflict would seem to be the presence of a large shareholder, who will be able to comply with the monitoring function better as he will have sufficient voting power to influence corporate governance of a company[23]. If we take dual-class structure, we see that the agency problem between managers and shareholders does not exist, as even though there are many dispersed shareholders, but only few of them carry a significant amount of voting rights. However, if one or more investors have the dominant position over the others, the most credible scenario is that they will make decisions which can maximize their private benefits. That is how dual-class stock creates a different agency problem between core shareholders with significant voting power and the “ordinary” ones. We will further analyze this problem by talking about minority shareholders protection in the next section.

The Council of Institutional Investors (or CII – a non-profit association of pension funds, other employee benefit funds, endowments and foundations) does not support dual-class stock, stating that it violates the boards’ and insiders’ accountability for the shareholders principle[24]. Ann Yerger adds that “structure is fundamentally flawed as a long-term capital model”[25]. Some scholars, like Smart and Zutter, claim that dual-class stock structure protects and encourages private benefits of control[26].

However, even though dual-class stock receives a lot of criticism, there are some supporters who think that separation of security ownership and control is not an entirely bad

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[21] (M. Burkart, 2007) Page 7
[22] Ibid.
[23] Ibid.
[24] Source of information - the official webpage of CII see: (Council of Institutional Investors)
[25] Ann Yerger’s (executive director of the Council of Institutional Investors) opinion in the the “Directors & Boards” Third Quarter, page 38 (2012)
[26] (Scott B Smart, 2003)

choice and could be an example of "good governance" too[27]. "Various studies of the Standard & Poor (S&P) 500 companies by Anderson et al. indicate strong positive correlations between family ownership and firm performance"[28]. Karl Hofstetter[29] argues, that companies should be allowed to choose a particular corporate governance structure, if it protects the interests of all shareholders. Moreover, he claims that even if controlling shareholder does get private benefits of control that might result into the "shared benefits of control" to all shareholders. In my opinion, that could be partially true. In the beginning of this paper we already stated that usually the ones who benefit the most from dual-class shares are the owners or insiders of a company. Assuming that the CEO of a company has the biggest percentage of votes (like it is in case of Facebook as an example) – he is the one who controls the company. Such an insider will have a very personal interest in how the company is performing, that is why it is very credible he will take any kind of failure of the firm as his own. The outcome of leader's personal pride will be that the value of the company is going to increase (assuming its good performance) - as will the returns of all shareholders. Moreover, "when the right person is in charge the dual-class structure can help companies avoid one of the problems besetting modern business—the short-termism of big institutional investors"[30]. It was noticed, that nowadays investors are way more impatient and pressure companies to show good results quarterly[31]. We will discuss these problems more precisely in the final chapter of this thesis.

Dual-class stock is also considered being the most extreme, but effective form of anti-takeover protection[32]. When the control over the company is held in one hands, the possibility of hostile takeover is equal to 0, as the board cannot be replaced involuntarily[33] and usually the owners do not want to be "kicked out" of their own company. This is very handful for young companies which have a big potential. We had already mentioned that technology product start-ups are more likely to adopt dual-class shares. We live in times, when new technologies are developing very quickly. If a young company wants to protect itself from bigger and stronger competitors, who would simply buy a start-up and profit from its new idea – firm has to take

[27] (Fama, 1983)
[28] (Hofstetter, 2005)
[29] Ibid.
[30] (Surowiecki, 2012)
[31] Ibid.
[32] (Gompers, 2008)
[33] (Robert Daines, 2001)

special measures to prevent this from happening. Well, dual-class stock offers a perfect protection.

There had been many discussions, which model of corporate governance is better –"one share-one vote" or dual-class structure, but the answer still stays unclear. Even though critics do not stop repeating how harmful dual-class shares structure is for the investor, but what we had seen so far is the growing number of companies who choose to adopt it. So, are the fears for investor protection in dual-class companies well-grounded?

1.3. Minority shareholders' protection

"The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders"[34]. It is a quote from OECD Principles of Corporate Governance, which are supposed to illustrate "the best governance" practices that should be followed by investors, corporations and policy-makers worldwide. We already mentioned the majority-minority shareholder problem, which dual-class stock might cause. Because of the huge importance of shareholder protection overall, I am willing to explain this issue in a more detailed way.

Why should a company worry about its minority shareholders and their opinion? You might think the author of this paper is asking an incredibly stupid question, giving the historical approach towards shareholders as the owners of a company, or the "shareholder primacy" rule[35]. In case we do agree that persons, who buy the securities of a company become its owners – the need to protect them and the goal to maximize shareholder value seem to be obvious. Indeed, that is exactly what we had seen so far – even the OECD Principles quoted before relies on theory that "equity investors have certain property rights"[36]. However, there had been "wind of changes" in this field, as the opinions denying shareholder ownership appeared. Current situation in the corporate world seems to have shifted and legal scholars started recognizing that "corporations are run by boards of directors, not by shareholders"[37]. Even if shareholders have the right to vote for the most important decisions, but in most cases, as it was also noticed by the same author – that is only a theoretical right, as voting procedure is heavily influenced by the

[34] OECD Principles of Corporate Governance, 2004, page 20 ((OECD), 2004)
[35] For the explanation about the traditional approach look at: (Larry D. Soderquist, 1978)
[36] OECD Principles of Corporate Governance, 2004, page 20, ((OECD), 2004)
[37] (Stout, New Thinking on 'Shareholder Primacy', 2011)

board of directors' decisions. According to Kent Greenfield, "if a firm is managed as if shareholder interests are all that matter, management will prefer risky endeavors that have high potential payoffs but are also high risk and have high variability"[38]. So, the basic idea here is that focusing on shareholder value maximization (which is believed to be achieved when share price increases) will probably result in short-term, rather than long-term results[39]. Why do I mention shareholder wealth maximization? Firstly, because the critics of dual-class shares claim that such structure does not protect the interests of minority shareholders and managers or other insiders of the company seek private benefits not thinking about the wealth of ALL shareholders. These accusations would make perfect sense if we would believe in the traditional approach discussed above. However, R. Anderson and D. M. Reeb, find no evidence that family ownership results in diminished wealth of minority shareholders, contrary – it can even improve the performance of a company, providing significant benefits for minority shareholders overall[40]. Contrary, there had been studies conducted, which show that "as insiders control more voting rights relative to cash-flow rights, they are more likely to make shareholder value-destroying acquisitions that benefit themselves"[41] and "managers with greater control rights in excess of cash-flow rights are prone to waste corporate resources to pursue private benefits at the expense of shareholders"[42]. But do we believe in that?

Times had changed and the financial crisis of 2008 also showed us that companies, which want to stay in the market for a long-term, have to focus on product innovation and the search of new areas for doing business, which sometimes demand to make unpopular decisions that will pay off in the future. Interestingly, it was noticed, that companies which do not declare shareholder wealth maximization as its primal goal are the ones who are more likely to achieve it[43]. "Shareholder value is a result, not a strategy… your main constituencies are your employees, your customers and your products. Managers and investors should not set share price increases

[38] (Greenfield, 2012)
[39] (Schrempf-Stirling, 2013)
[40] (Anderson, 2003)
[41] (Masulis, 2008)
[42] Ibid.
[43] Take as an example Jack Welch, the CEO of General Electric, who raised the value of a company from $14 billion to $484 billion at the time of his retirement. According to him, believing that the purpose of a corporation is to maximize shareholder value is "the dumbest idea in the world". For more see: (Denning, 2011)

as their overarching goal."[44] Finally, shareholder wealth maximization is no longer seen as a goal of a company[45] and shareholders are not seen as the "owners" of a company[46].

Let's come back to the question the author of this paper asked before – why should a company care about minority shareholders and their opinion? We already spoke about the traditional view that shareholders "own" the company and "shareholder primacy rule" must be followed according to it. We also said that there had been some criticism on this theory and shareholders should not be seen as privileged part of a company. It is also worth noting, that according to the data[47] the average share holding does not even last half a minute due to high frequency trading! These terrifying results raise a question – how can a firm allow its minority shareholders, who change that fast to have a significant role in company's corporate decision making? It does not seem that such an investor would be much concerned about the future strategies of the firm, or its long-term results. Basically, it means that investors simply seek to profit from the shares they buy by reselling it to others. We can assume there is no difference for them how company will be governed as long as they will benefit from it. This theory would perfectly explain the huge attention that dual-class companies get from investors. Otherwise, why would they invest into a company, which harms their interests?

We will move on to the next section of this paper and try to find out does the popularity of dual-class companies comes from their ability to outperform firms with single class shares in long or short terms.

1.4. Performance of companies with different corporate structure - empirical evidence

There had been many studies conducted in order to find out which corporate structure is more efficient. However the results had been contradictory so far. Some scholars like E. Boehmer found out already in 1996, that dual-class stock companies outperform single class companies as regards stock returns and accounting performance[48]. Family owned firms, which as we said before, are more likely to adopt dual-class stock structure, had been recognized to bring better stock returns and accounting performance compared to non-family owned companies as

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[44] Ibid. Quoting Jack Welch.
[45] See articles: (Hensen, 2013) and (Nocera, 2012)
[46] (Stout, Shareholders as Owners: Legal Reality Or Urban Legend?, 2010)
[47] (Farrow, 2012)
[48] (Boehmer, 1995)

well[49]. Meanwhile Bebchuk, Kraakman and Triantis claim that dual-class shares cause higher agency costs[50]. Contrary, the study of equity ownership and firm value in emerging markets by Karl V. Lins showed that if management enjoys bigger voting power than their cash-flow rights are it negatively affects the stock price of the company[51]. Also, the research[52] in 2012 initiated by the Investor Responsibility Research Center Institute (IRRCI) came up with very significant results. The main findings were:

1) The number of companies with dual class stock had increased significantly (from 114 controlled companies, even 79 have adopted structure with unequal voting rights).
2) Non-controlled companies outperform their rivals during 3-year, 5-year and 10-year periods (see the table below).

Ownership	1-Year Avg. TSR	3-Year Avg. TSR	5-Year Avg. TSR	10-Year Avg. TSR
Non-Controlled	14.81	12.96	1.22	9.76
Controlled	16.33	13.08	1.55	9.28
Controlled: Multiclass	17.48	12.35	0.93	7.52
Controlled: Single class	13.78	14.91	3.31	14.26

Source: Review of Research Findings and Q&A, Investor Responsibility Research Center Institute & Institutional Shareholder Services, available at: http://irrcinstitute.org/pdf/FINAL-Control-Webinar.pdf

3) Companies with dual-class shares face more stock price volatility (see table below).

	Multi-class control	Dispersed ownership	Single class control
10-year return (annualized)	7.52%	9.76%	14.26%
10-year volatility (annualized)	13.52%	11.34%	10.10%

Source: Review of Research Findings and Q&A, Investor Responsibility Research Center Institute & Institutional Shareholder Services, available at: http://irrcinstitute.org/pdf/FINAL-Control-Webinar.pdf

If we rely on these numbers provided above, we see that companies with dual class stock are more likely to bring "a temporary luck", as their returns are highest only in the first

49 (Anderson, Founding Family Ownership and Firm Performance: Evidence from the S&P 500). This evidence was also confirmed by the University of Toronto's study in 2013, see: (McFarland, 2013)
50 (Lucian A. Bebchuk, 2000)
51 (Lins, 2003)
52 Study results are available online, see: (Institute, 2012)

year and the lowest after 10-year period. That might confirm our hypothesis that investors are attracted to dual-class companies for their momentary good performance and quick benefits provided. Also, these results force us to question the argument of dual-class companies' supporters about "long-term vision", which according to them can be easier materialized using this corporate structure.

1.5. Conclusion

The first chapter of this thesis had provided the reader with general information about dual-class shares and their advantages/disadvantages. Now we know that unequal voting rights can be an effective protection against takeovers, help to overcome the short-termism of public investors and create value for all shareowners. However, we had seen the negative effects it might have too. One of the biggest threats of dual-class shares is that a new agency problem between controlling shareholder (in terms of voting power) and the minority shareholder comes to sunlight. In case current owners' vision turns out not to be the most successful – shareholders have little say about the necessary change of course, as the voting power is held in hands of insiders, who rarely admit their mistakes. Dual-class stock structure indeed leaves smaller investors to "go with the flow" as they do not have any real power to change the will of dominant shareowner. However, we had also discussed that controlled companies, which have dual-class stock, tend to underperform their rivals non-controlled firms in the longer term, at least, according to one study. These findings had made us question why do investors still choose to put their money in companies that are so much criticized for being an example of "bad governance".

Keeping in mind everything we said so far, we will move on to Chapter II, where we will analyze corporate governance structure of three well-known companies – Facebook, Google and Zynga. All of these companies chose to adopt dual-class stock and as their IPOs took place at different time, we will be able to test our hypothesis about investor short-termism and answer the most important question – can dual class stock companies be called an example of good corporate governance?

CHAPTER II

Case study findings

2.1. Google's corporate structure

"To organize the world's information and make it universally accessible and useful."

Google's Mission Statement.

Google has one of the most valuable brand names in the world[53] and the word "google" itself is already used as an adjective all over the globe. According to "Fortune" magazine, Google hits number one as the best company to work for five years in a row[54]. The search giant, as a privately held company, was founded by two Ph.D. students Larry Page and Sergey Brin with their first office based in a garage back in 1998[55]. Since then, company had grown so big, that Microsoft - its biggest competitor - already calls it a monopoly[56].

2.1.1. Google's Initial Public Offering

Google's listing on NASDAQ in 2004 caught a lot of attention from media world, as it was different in some important aspects, especially corporate structure, which was unusual for such technology companies as Google at that time. *"Standard structure of public ownership may jeopardize the independence and focused objectivity that have been most important in Google's past success and that we consider most fundamental for its future. Therefore, we have implemented a corporate structure that is designed to protect Google's ability to innovate and retain its most distinctive characteristics."*[57] This is how the founders of Google justified their decision to adopt dual class stock structure. As they explained further, after the Initial Public Offering Larry Page, Sergey Brin and Eric Schmidt will be holding 37.6% of the voting power and managers together with the board of directors as a group will have 61.4% of control[58]. But

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[53] According to Forbes "The most valuable brands" list, Google enjoys the fifth place. See list at: (Forbes, 2013)
[54] (Fears, 2014)
[55] Information can be reached on the official webpage of Google, see: (Google)
[56] (Bort, 2013)
[57] 2004 Founders' IPO Letter from the S-1 Registration Statement, see: (Google, 2004 Founders' IPO Letter)
[58] Ibid.

corporate structure was not the only thing that was special about Google's IPO. Interestingly, the founders decided not to use the traditional, investment bank-led offering, but chose Dutch auction structure, which was very rare at that time[59]. The purpose of such decision was to make Google's shares more accessible to the general public, especially, small investors and let the market to set the initial share price[60]. Dutch auction mechanism works as follows – "investors place orders for the number of shares they want, and at what price. The final price is the one at which there are enough investors willing to buy all the shares in the offering. Investors who bid at or above the "clearing price" receive shares at that price, even if they'd bid higher; lower bids go unfilled"[61]. The main differences between traditional model and Dutch auction are given in the table below.

	Traditional IPO	Dutch Auction IPO
Pricing Mechanism & Share Allocation	Coordinated by underwriting investment banks	Determined by market via investor bids
Role of Underwriters	Underwriters set the IPO price, market the IPO, and support the price in the event of an undersubscribed offering	Underwriters' price-setting power virtually eliminated; lower transaction costs; underwriters still market the IPO
Post-IPO Price Effect	Potential for a larger pop, because the stock is "underpriced" prior to the IPO	Less potential aftermarket pop, due to relatively more efficient pricing and share allocation

Source: Eugene Choo, Going Dutch: The Google IPO, 20 Berkeley Tech. L.J. 405 (2005). Available at: http://scholarship.law.berkeley.edu/btlj/vol20/iss1/45

The "road" to the IPO was not a soft one for Google as it faced some difficulties before it took place. One of them was founders' rash interview for Playboy magazine, which violated the Securities and Exchange Commission (SEC) rules of "quiet period" just before the Initial Public Offering.[62] Another negligent mistake was made when Google failed to register the shares it issued for its employees as required by federal and state securities laws and had to buy them back.[63] Because of these publicly discussed problems, Google's expected initial price of $108-

[59] (Choo, 2005)
[60] Ibid.
[61] (Demos, 2012)
[62] (Olsen, 2004)
[63] (Olsen, Google may have issued shares illegally, 2004)

$135 dropped to $85-$95[64]. Even though, there were different opinions on whether Google's IPO was a success or not[65], the facts are: Google raised $1.67 billion and the opening price of $85 jumped to over $100 in the same day and the stock price was mainly only rising since that time, even reaching unbelievable 900% returns back in 2013[66]. Should we be thankful to corporate governance structure for that?

2.1.2. Corporate governance

"Google is not a conventional company. We do not intend to become one."[67] These are the first two sentences of founders' IPO letter to investors. Google clearly states, that even though it goes public - it does not want their corporate governance to be influenced by the outside pressure (explained in other words – they don't want public investors intervening in company's strategy making process). That is the basic motive of choosing dual-class shares structure, which allows a public company to be governed more like a private one.

At the time of the IPO, Google issued two types of shares – Class A, which carried one vote per share and Class B with 10 votes attached to one share. Not a big surprise – the main owners of preferred stock being Page, Brin and Schmidt. Right after it happened, an influential proxy adviser Institutional Shareholder Services (ISS) rated Google's corporate governance only at 0.2 out of 100 in the S&P 500 index[68]. Company's corporate structure was criticized by ISS special counsel Patrick McGurn, who said that "Google lacks the usual checks and balances provided at public companies by shareholder votes <…> Rank-and-file shareholders have no meaningful avenue for recourse -- other than selling their low-vote shares."[69] Other problems in Google's corporate governance include the requirement of 60% of total votes of investors to approve any merger (let's not forget that management and Board of Directors own 61.4% of total voting power) and the fact that the Board of Directors do not need the approval of shareholders to change the bylaws[70].

[64] Information taken from: (CNN.com, 2004)
[65] See: (Hodrick, 2004), also: (Nocera J. , 2004)
[66] (Russolillo, 2013)
[67] 2004 Founders' IPO Letter from the S-1 Registration Statement, see: (Google, 2004 Founders' IPO Letter)
[68] (Pender, 2004)
[69] (Plitch, 2004)
[70] (Lavelle, 2004)

However, not everything about Google's corporate governance is bad – "Google has an audit committee, as well as a compensation committee, that consists of only independent outside directors, ISS said. It has also established a corporate governance committee, which regularly reviews the performance of its Board and has a CEO succession plan."[71]

According to the Corporate Governance Guidelines, available on Google's official webpage[72], "A majority of directors on the Board will be independent as required by the NASDAQ Stock Market. The Board also believes that it is often in the best interest of Google and its stockholders to have non-independent directors, including current and (in some cases) former members of management, serve as directors." Let's take a look at the current composition of the Board[73]:

MEMBER	POSITION
Larry Page	CEO and the founder of Google (insider);
Sergey Brin	Founder and member of the Board since 1998 (insider);
Eric Schmidt	Currently an Executive Chairman and the member of the Board since 2001 (insider);
L. John Doerr	Member of the Board since 1999, one of Google's original investors and directors (insider);
Diane B. Greene	Member of the Board since 2012 (independent);
John L. Hennessy	Member of the Board since 2004, has a number of business relationships with Google, also invested in Mr. Doerr's company "Kleiner Perkins" (not very independent);
Ann Mather	Member of the Board since 2005 (independent);

[71] (Kawamoto, 2004)

[72] Corporate Governance Guidelines, established by the Board of Directors of Google Inc. see: (Google, Corporate Governance Guidelines)

[73] I took a look at each member of the Board and tried to find any kind of information about past business relations, friendship, or any type of connection that would lead to the conclusion that these people might not have a completely independent opinion. The remarks in brackets are based on my personal observation.

Paul S. Otellini	Member of the Board since 2004 (independent);
K. Ram Shriram	Member of the Board since 1998, one of the first Google's investors (insider);
Shirley M. Tilghman	Member of the Board since 2005 (independent).

As far as we see, the majority (six out of ten) of Directors should not be considered as independent due to their previous business relationships with Google. Even though there is no proof (at least officially accessible), it is hard to believe that the rest four directors are completely independent and were not chosen because of friendship or other personal matters. Surely, Google can be called a controlled company, as a group of people together hold more than 50% of voting power. "NASDAQ currently allows a "controlled company" to exempt itself from the requirements to have a majority of independent directors on its board and to have independent compensation and nomination committees."[74] Basically, this exemption legally empowers Google's founders to control the company without being supervised or advised by the people from the "outside".

Recently, Google felt that the founders' voting power will dilute, as more and more stock is being issued as compensation to the employees. [75] That is why, the third class of shares - Class C, which holds no voting power, was introduced. "We have a structure that prevents outside parties from taking over or unduly influencing our management decisions. However, day-to-day dilution from routine equity-based employee compensation and other possible dilution, such as stock-based acquisitions, will likely undermine this dual-class structure and our aspirations for Google over the very long term."[76] Google's founders claim that their dual-class governance structure was probably the main determinant of their success, which inspired many new technology companies to use the same approach[77].

[74] (Commission, Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Clarify Nasdaq's Definition of "Controlled Company", 2009)
[75] (Lam, 2014)
[76] 2011 Founders' Letter, where they first mention the plans of introducing third class of shares, for the full letter see: (Google, 2011 Founders' Letter)
[77] Ibid.

However, let's take a look at company's corporate culture, which according authors of this thesis strong belief - had a lot to do with Google's success.

2.1.3. Google's corporate culture

Even though Google is not called the example of good corporate governance, as its' critics would say, one thing is for sure. It has an amazingly well developed corporate culture. As we mentioned before, Google had been recognized as the best company to work for by Fortune Magazine. It is not surprising, knowing how much Google cares about its employees. Free meals, massages, haircuts, health and dental care, gyms, swimming pools – all these things and many more are provided for Google's employees[78]. The philosophy of corporate culture is expressed in "ten things we know to be true"[79] written by the founders. The first and the most important thing which is mentioned there – "focus on the user and everything else will follow". This illustrates that the main goal of the company and its employees is to make clients satisfied and introduce products that are of best quality. Google uses the famous 70/20/10 model, which means that employees are expected to spend 70% of their time on their core business tasks, 20% on related projects and 10% on unrelated new innovations.[80] This policy encourages employees to work on ideas that they feel will be important tomorrow. So far this strategy seems to be working well, as Google do not stop innovating and entering new business fields, for example the newest idea of producing Google's self-driving cars[81].

As we mentioned in the first chapter – sometimes focusing on other things than shareholder wealth maximization might serve for that purpose even better and even "bad corporate governance" cannot stop the growth and success of such company and Google is a perfect example of that.

[78] (Jackson, 2013)
[79] (Google, Ten things we know to be true)
[80] Information source: Blog of Ben Morrow, see: (Morrow)
[81] (Claburn, 2014)

2.2. Facebook's corporate structure

"To make the world more open and connected"

Facebook's Mission Statement.

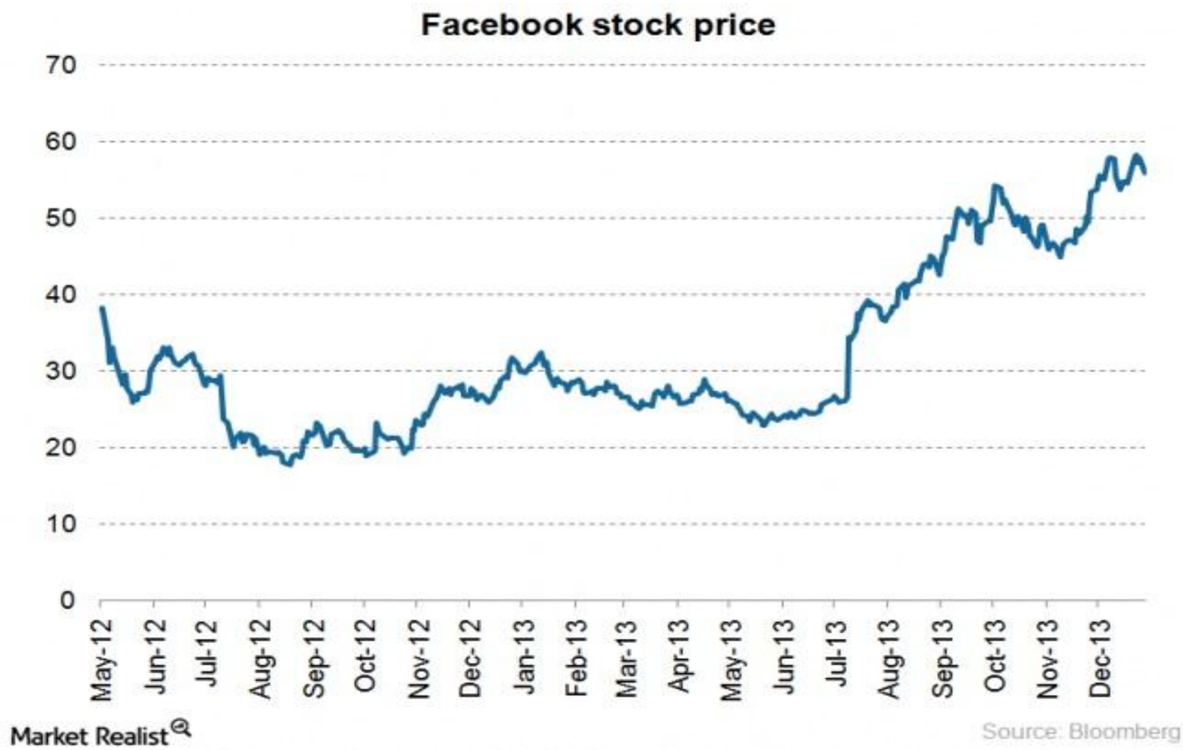
Facebook (or FB in short) is an extremely popular social network used by more than 1 billion monthly active members.[82] Facebook was founded by Mark Zuckerberg, a nineteen year old Harvard student in 2004[83]. "A week after he launched the site in 2004, Mark was accused by three Harvard seniors of having stolen the idea from them."[84] As we see, even the creation of this company caused a scandal, but did not prevent it from becoming the most popular site around the world.

2.2.1. Facebook IPO

Facebook went public on NASDAQ in May 18, 2012. It was valuated at $104 billion, which made the Initial Public Offering one of the largest in history.[85] FB stock started trading at $38 per share and raised $16 billion for the company.[86] Facebook did not use Dutch auction like Google did, instead it followed traditional model and let its underwriters (Morgan Stanley, JP Morgan and Goldman Sachs) to decide the price. As good as this might had sounded, but the IPO of Facebook was considered as a failure. FB share price dropped by 11% during the second day and news had spread that the banks which lead Facebook's IPO might be facing official investigation about "selective release of negative news".[87] Some journals wrote that "Morgan Stanley analyst had cut his revenue forecast for Facebook in the days before the offering, and may have only told top clients verbally, rather than spreading the word publicly"[88]Moreover, stock price did not stop falling till September, when it reached its all times lowest - $17.58 price

[82] For the source of data see: (Brain, 2014)
[83] (Carlson, 2010)
[84] Ibid.
[85] (Evelyn M. Rusli, 2012)
[86] (Womack, 2013)
[87] (McMillan, 2012)
[88] Ibid.

per share.[89] We can see Facebook's share price changes during the first 20 months as a public company in the chart below.



There had been many discussions about possible reasons why the most anticipated IPO had turned into a complete "fiasco" as Wall Street Journal called it.[90] The executives of Facebook blamed NASDAQ for the technical chaos it caused already at the first day of trading.[91] Before the IPO, Facebook was trading its shares on private secondary markets like SharesPost and SecondMarket, where the demand was high and its stock price was reaching $44.10![92] As a result, FB's underwriting banks increased the initial price (from $28-$35 to $35-$38) just before the IPO took place, citing huge demand.[93] That is why it had been discussed that FB might have

[89] (Reisinger, 2012)
[90] (Weidner, 2012)
[91] Facebook shares were supposed to start trading in the market at 11 o'clock, but it was late half-hour. Some investors complained that they were unable to buy FB shares, or finally got them for a bigger price than they expected.
[92] (Pender, See where Facebook stock traded before the IPO)
[93] (Nair, 2014)

been over valuated compared to what it actually earned.[94] Sadly, it took more than a year for the famous social network's shares to reach their Initial Public Offering's price.

Even though Facebook as a public company faced a crisis and some journalists were predicting a quick "death" for the company, but it did not happen and FB succeeded to maintain their positions as dominant social network and adapt to changing needs of the society.

2.2.2. Corporate governance

"Facebook ownership structure should scare investors more than botched IPO"[95] As we see, some commentators believe that FB's stock structure is a threatening sign. What is believed to be so scary about it? Yes, that's right – unequal voting rights. The interesting thing is that FB adopted its dual-class share structure not during the Initial Public Offering, but years ago, back in 2009, saying its existing shareholders want to maintain control over certain issues.[96] Facebook has two types of shares – Class A carrying one vote per share, which had been offered to the general public during the IPO and Class B – carry 10 votes per share. As Mark Zuckerberg revealed in the Statement of Beneficial Ownership[97] filed on February 7, 2014 - he holds 478914465 shares in the company, which are equal to 19.6% of all outstanding shares. "There were 576,587,559 shares of Class B Common Stock outstanding as of December 31, 2013 <…> including the 478,914,248 shares of Class B Common Stock beneficially owned by Mark Zuckerberg."[98] Not all of these shares are personally owned by Mr. Zuckerberg, but he was clever enough to make voting agreements with other shareholders, that gave him proxy rights. According to Facebook's S-1 filing, if initial shareholder decides to sell its Class B stock, it will be automatically converted to Class A stock. Even if other shareholders decide to sell their Class B shares, it will not dilute Zuckerberg's control over votes, contrary – it will increase it. Now Zuckerberg holds 57% of the voting power, which allows him to make the most important decisions solely.[99] As more than 50% of the control is held by one person, Facebook describes itself as a controlled company.[100] As we discussed in the previous section, analyzing Google's

[94] (Cusumano, 2012)
[95] (Bigman, 2012)
[96] (Carlson, Facebook Creates Dual-Class Stock Structure To Maintain Control After IPO, 2009)
[97] Form SC 13G Statement of Beneficial Ownership, see: (Facebook, 2014)
[98] Ibid.
[99] (Yglesias, 2014)
[100] (Bigman, 2012)

corporate governance structure – the status of a controlled company allows enjoying the exception from corporate governance rules applied to public companies – they are not obligated to have majority of independent directors, compensation or nominating committees. As well as Google, Facebook has its own Corporate Governance Guidelines[101], where it is written that "Notwithstanding the company's status as a "controlled company," the Board shall be comprised of a majority of directors who, in the business judgment of the Board, qualify as independent directors under the applicable rules, regulations, and listing requirements of the stock exchange upon which the Company's securities are listed for trading." Current composition of the Board of Directors[102]:

MEMBER	POSITION
Mark Zuckerberg	Founder, Chairman and the CEO (insider);
Sheryl Sandberg	Chief Operating Officer since 2012, first joined FB in 2008 (insider);
Marc Andreessen	One of the major Facebook investors (insider);
Erskine B. Bowles	Sit on the board of Morgan Stanley, which was the underwriter during Facebook IPO (insider);
Susan Desmond-Hellmann	The chancellor of University of California (independent);
Donald E. Graham	The leading independent director, however the independence could be questioned as he serves as the Chief Executive Officer of The Washington Post Company, which as a coincidence spent $9.6 million on Facebook ads from 2009 to 2011;
Reed Hastings	Board member since 2011, CEO and Chairman of Board of Directors of Netflix (independent);
Peter A. Thiel	An early Facebook investor (insider).

The independence of majority of the Board members raised doubts even before Facebook's IPO.[103] It was noticed, that many directors had some kind of connections with FB. As we see now, not much had changed and the Board is composed mainly from those people

[101] Facebook Corporate Governance Guidelines, see: (Facebook, Corporate Governance Guidelines)
[102] For the full list see: (Facebook, Board of Directors)
[103] (Murphy, 2012)

who are one way or another related with the company. Anyhow, the problem with Facebook is not the lack of independent directors. Even if FB would have more of them, it would not make any difference, as majority of voting power belongs to Mark Zuckerberg anyway. Let me explain this further. Every public company has shareholders, who elect the Board. The latter is responsible for the supervision of the management team. In case the performance of the manager is not as good as expected, the Board of Directors has a power to replace CEO. Shareholders on the other hand are responsible for the election of the Board. According to this scheme, a company works following its own "checks and balances" system, which is created to ensure that none of these organs would expropriate their power. However, such "security" system is disrupted in companies with dual-class shares like Facebook. As we discussed before, Mark Zuckerberg controls the majority of voting power. Basically, he as the biggest shareholder elects the Board. Moreover, he is the Chairman of the Board AND a Chief Executive Officer! So, what we see is that Mark Zuckerberg elects Mark Zuckerberg to supervise Mark Zuckerber. But that is not all yet – according to the IPO filings "in the event that Mr. Zuckerberg controls our company at the time of his death, control may be transferred to a person or entity that he designates as his successor."[104] As we see, the founder does not leave any hope of ever being pushed out of Facebook, unless voluntarily. Can such an extreme form of corporate governance be considered as an example for the other companies? The practice showed that at least partially yes, because Zynga, LinkedIn and Groupon followed the example and adopted the majority control model.[105]

Facebook is currently making some costly new acquisitions, such as the purchase of WhatsApp ($19billion)[106], Oculus ($2 billion)[107] and Moves (the price is not yet revealed)[108]. It seems, that Facebook is trying to become not only a social platform used to connect with people you know, but is also searching for other possibilities how to attract customers: "Mobile phone is the platform of today, and now we're also getting ready for the platforms of tomorrow. Oculus has the chance to create the most social platform ever, and change the way we work, play and communicate."[109] According to Facebook's first quarter results[110] of 2014, published on April 23,

[104] Facebook Registration Statement Form S-1, see: (Commission, 2012)
[105] (Jeff Green, 2012)
[106] (Sikka, 2014)
[107] (Parkin, 2014)
[108] (Li, 2014)
[109] (Zeiler, 2014) Quoting Mr. Zuckerberg.
[110] See: (Facebook, Facebook Reports First Quarter 2014 Results, 2014)

the company is growing really fast (revenues are up by 72%!). Taking into account recent acquisitions – Facebook seems to be ready to innovate and adapt to the changing needs of its users. Of course, all of these strategic decisions have to be approved by Mark Zuckerberg. The threatening fact here is that Facebook relies on one man's ability to predict the future, as no other shareholder has enough voting power to oppose the decisions M. Zuckerberg makes. That is why, when you invest in FB, you make a bet not on the company, but on its founder.

2.2.3. Facebook's corporate culture

Similar to Google, Facebook is being criticized for governance structure, but it can be congratulated for the strong corporate culture that it has. FB was rated as the best company to work for according to the Employee's Choice Awards 2013[111]. "We strive to make Facebook a place where everyone is able to have an impact doing what they love. Receiving this award is a testament to the culture of builders we've worked hard to create."[112] Facebook provides breakfast, lunch and dinner for free; also gym, laundry service and weekly lecturers by famous entrepreneurs are all at no cost for the employees.[113] At the office they can relax while playing games like ping-pong, or foosball. Facebook ensures that its employees would have enough time to rest or recover from illness (11 holidays, 21 days of paid time off and unlimited sick days).[114] No surprise that FB was selected by the employees as a best work place!

Organizational culture in Facebook is just splendid as Mark Zuckerberg made his best to keep the relaxed and open atmosphere in the office. "Facebook provides a great amount of freedom to employees, who enjoy open offices, undivided desks and no standard work schedules. This is because Zuckerberg believes that time and space freedom encourages team-work, collaboration and communication."[115] Employees are encouraged not to be afraid to take risk and come up with new ideas. As one former worker revealed[116], once a week employees had a meeting with management team, including Mark Zuckerber himself. "These sessions were tremendously valuable in building a culture in which every employee knew that they had direct access to the CEO and could openly express any concerns or frustrations that they may have or

[111] (Smith, 2012)
[112] Ibid.
[113] (Zatarain, 2012)
[114] Ibid.
[115] Ibid.
[116] (Colleran, 2013)

get answers to questions that most companies would never have addressed in a public forum."[117] As Facebook grew and opened more offices in all around the world, it was important to make sure that corporate culture would be "transferred" too. It was done by sending "the landing team", which helps to establish a new office and "acts as a "culture carrier""[118].

As we can see, the corporate culture inside of Facebook demands for innovation and a total devotion to FB's mission mentioned before. As long as company keeps the general spirit that each employee is important and could change the future – more talents it will attract.

2.3. Zynga's corporate structure

"Our mission is to connect the world through games"

Zynga's Mission Statement.

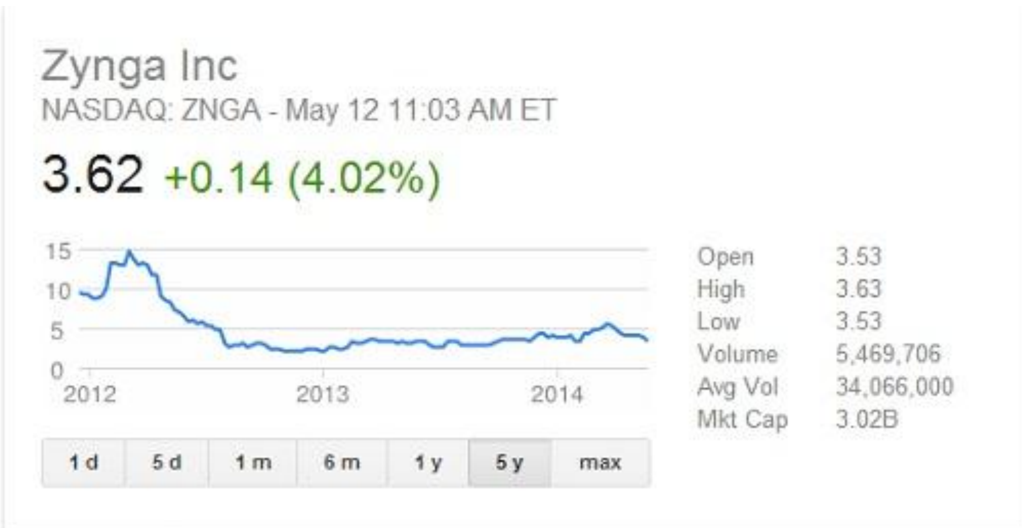
Zynga is a social game services provider, which brought to the society some really popular games, like Zynga Poker, FarmVille, Mafia Wars etc. The company was founded by Mark Pincus in 2007 and already has more than 1 billion customers worldwide!

2.3.1. Zynga's Initial Public Offering

Zynga went public on NASDAQ in December 16, 2011 with its shares being initially priced at $10. The company raised $1 billion on its IPO and was valuated at $7 billion.[119] Zynga's valuation seems huge, but not as big as it was expected – before the Initial Public Offering the company was valuated at $14 billion![120] Even though the stock price rose 11% during first trading hours, but in the end of the day, it closed at $9.45.[121] Zynga picked some well-known banks to help them during the IPO – the team consisting of Morgan Stanley (leading bank), Barclays Capital, JP Morgan and Goldman Sachs.[122] Zynga's IPO was one of the most anticipated events of the year, but went "SplatVille"[123], like one journalist called it. The company reached their highest share price of $14.50 in March 2012, but since that time it was

[117] Ibid.
[118] (Zatarain, 2012)
[119] (Rushe, 2011)
[120] (Boorstin, 2011)
[121] (Rushe, 2011)
[122] (Bertoni, 2011)
[123] (Hof, 2011)

steadily falling till it cost $3.[124] So far Zynga was unable to get back at least half of its IPO price. "One key reason Zynga suffered so much in the waning days of the Pincus era was the failure to move more strongly into mobile."[125] The company is strongly attached to Facebook, as their games got so popular due to the broad audience FB had provided.[126] The absence of a long term vision in Zynga was noticed even before the IPO, as the analysts were warning the company about growth perspectives.[127] Below we can see Zynga's stock price change since its Initial Public Offering.



Source: Yahoo Finance

Even though Zynga's situation in the market is not very promising right now, for companies like this one, things can change pretty fast if they develop few new games that will become popular. Who knows, maybe the new CEO of Zynga[128] will come up with some interesting ideas?

2.3.2. Corporate governance

Company's founder – Mark Pincus wrote a letter to the shareholders, where he stated that "Zynga is a meritocracy"[129]. The term "meritocracy" means a society, governed by people who were selected according to their merits. Sounds very democratic and fair you might think.

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[124] For the source of information see: (MSN)
[125] (Chupka, 2014)
[126] (Hof, 2011)
[127] (Boorstin, 2011)
[128] (Geron, 2013)
[129] Letter can be found in Zynga's Prospectus, page 32, see: (Commission, Zynga's PROSPECTUS, 2011)

However, the reality in Zynga is a bit different. Similar to Facebook, dual class structure was adopted before the IPO, just not with two types of shares, but three. Class A carries one vote, Class B – 7 votes and Class C – 70 votes per share![130] "Outstanding shares of Class B common stock will represent approximately 72.5% of the voting power <…> and outstanding shares of Class C common stock will represent approximately 25.7% of the voting power of our outstanding capital stock. Mark Pincus <…> holds shares of Class B common stock and all of the shares of Class C common stock and will control approximately 36.2% of the total voting power of our outstanding capital stock immediately following this offering." [131] No other technology company issued three classes of shares before Zynga, or created a separate class for the founder solely. As you might guess, the general public is entitled to Class A shares only. It had been said in the Prospectus, that the owners of Class B shares are executive officers, employees, directors and their affiliates. Together with Class C shares, which are owned by Mark Pincus they hold approximately 98.2% of the voting power.[132] As we can see, Zynga is totally controlled by the insiders. The argument company (alongside with other firms which have dual-class stock) uses to support this decision is that it will allow to focus on the long-term strategy: "If we lose the services of our founder and Chief Executive Officer or other members of our senior management team, we may not be able to execute our business strategy."[133] Zynga relies on its insiders, especially founder's ability to act on the best interest of the company. However, if we presume that Mark Pincus' strategy was the key to Zynga's success at least before the IPO – maybe he is also responsible for its failure afterwards? While the answer to this question stays unanswered, we see that Zynga tries to get back on its feet, first move towards it being the change of CEO in July 2013.[134] Interestingly, the stock price went up, once the news about a changing leader came out.[135] It could be a signal that a company lead by the founder can perform very well in the beginning of its existence but when it comes to the long term approach and the company's further growth – having the same person in charge might be even harmful. Looks like in Zynga's case we saw how a company had "outgrown" its leader – the bigger

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[130] (Lamb, 2012)
[131] Zynga's Prospectus, see: (Commission, Zynga's PROSPECTUS, 2011)
[132] Ibid.
[133] Ibid.
[134] Zynga releases the news about the new CEO, see: (Zynga, 2013)
[135] (News, 2013)

company grew – the harder it got to manage it. As we see, not all the leaders can "transform" together with their companies.

Don Mattrick - the new CEO - made a lot of changes in Zynga's corporate governance – fired Chief Operating Officer, Chief People Officer and Chief Technology Officer[136]; recently appointed David Lee, who helped to boost Best Buy stock price, as a new CFO of Zynga[137]. "We are taking layers out of the executive rank to get senior leaders closer to important product initiatives. With that in mind, I have asked the leaders to sharpen their focus and properly densify talent to resource teams"[138] The current CEO seems to be determined to improve Zynga's performance in the market. Will he succeed we will be able to see in the near future.

2.3.3. Zynga's corporate culture

If we compare the conditions of work in Google, Facebook and Zynga we would definitely find some similarities. Zynga provides employees with a freshly made food, free beer, gym, massage services, even hotel-like amenities to keep employees closer to their workplace. More about all the fun in Zynga you can find in the article[139]. However, other journalists argue, that "eating nutritional food, having access to on-site childcare, and spending long hours in buildings designed to inspire healthy living represent truly meaningful benefits, but these are the wrong measures of organizational culture"[140]. In cases of Facebook and Google we saw that innovation and cooperation between employees are highly encouraged. How is it in Zynga? "In dozens of e-mails to a companywide list, frustrated workers complained about the long hours and stressful deadline periods. The quarterly staff survey solicited 1,600 responses, with plenty of criticism, including one person who said he planned to cash out and leave after the initial public offering."[141] "Zynga's bad reputation has prevented it from acquiring some top talent. Before PopCap was purchased by EA for $750 million plus stock, Zynga reportedly offered $950 million. PopCap rejected the higher offer over fears that Pincus' personality would infect their offices."[142] It seems that the founder of Zynga evaluates his employees work only by looking at

136 (Farivar, 2013)
137 (Grubb, 2014)
138 (Avelar, 2013) Quoting Don Mattrick.
139 (Freeman, 2012)
140 (Seidman, 2013)
141 (Rusli, 2011)
142 (Tito, 2011)

the numbers and how much money they bring for the company, which makes creative people to abandon the company. Maybe new CEO will be able to improve it too and Zynga will not be seen as a bad example of corporate culture.

2.4. Conclusion

We analyzed three big USA companies – Google, Facebook and Zynga in this chapter.

The oldest one – Google - seems to have successfully profited from dual-class shares structure. Founders retained the control and will do so in the future, as non-voting shares had been introduced recently. The company performs very well as innovation is its primal goal. Facebook's situation is a bit different, as it had difficulties right after the IPO, but now the share price seems to be doing pretty well. FB also creates that relaxed and innovative environment, so their employees are happy to be a part of the company. Recently, the company made some meaningful strategic acquisitions, which - as founder said - are supposed to pay off during the long term. However, for our third company Zynga, things are not going so well at the moment. Before the IPO the company was very popular and made lots of money. Sadly, after going public everything turned the opposite. It seems that the inabilities to innovate and to create a long-term vision were the main reasons of Zynga's failure. Of course, its dual-class stock structure does not inspire a lot of trust among the investors also.

One of the main arguments that all three companies used to justify their decision of adopting dual-class stock was the unique "value" their founders being main decision makers brings. It had been underlined that the success of these companies directly depends on the distinctive vision that the founders have. The pressure from the outside investors is seen to be destructive for the "bright" future of these firms. For Google and Facebook that turned out to be true – we had seen that the leaders of these companies remained dedicated to their ideological purposes we mentioned in this chapter. That had brought positive results not only for founders but also all the stockholders. However, Zynga's case was a bit different, as Mark Pincus proved not to have a long-term vision of the company in the first place.

Having all what was said in mind, I came up with the conclusion that "one size does not fit all" in corporate governance. We cannot indicate one model which we could call "good corporate governance", as one success scenario will not have the same effect on all companies.

Firms, which we analyzed in this chapter, have a lot of similarities in their corporate governance – dual-class shares, strong leaders, corporate culture… Yet, it seems that the main driver to the success is not their "good" or "bad" governance as some would argue[143], but the ability to innovate, to focus on the changing needs of the customers and create the challenging atmosphere for their employees. This hypothesis is clearly confirmed if we compare Google and Zynga. Both of these companies have the same corporate governance system, also invest into their culture, but their performance differs quite a lot. Google was able to profit from dual-class structure and dedicate to innovation of their products and search of new business possibilities. This company is a perfect example how dual-class structure can help to achieve long-term results, while the board of directors is insulated from the outside pressure. However, for Zynga, the controversial stock structure did not do much good. Company's - or better said – its founder's inability to innovate and lack of strategic plan for the future were the main reasons for Zynga's struggle. Dual-class share structure in this case probably had the adverse effect on the stock price, as it just enhanced the mistrust of the investors.

These concrete examples that we had seen in this chapter further raise the question of dual-class shares perspectives in the future.

[143] Like we said before, there is no consensus about dual-class shares structure – to some critics it seems value destroying structure, to the supporters – value enhancing structure. Basically, both sides are right.

CHAPTER III

New tendencies towards dual-class stock

While in the previous chapters we concentrated on historical review of dual-class shares and the analysis of several companies, which adopted this structure – now it is time to move on towards the main question of this thesis. Do dual-class shares have a future and what are the new trends in the market, which could have an impact on the current public opinion about them?

3.1. Shareholder activism

As we explained before, dual-class stock is created to protect the controlling shareholder[144] from the pressure of other investors and ensure that his decision making power could not be weakened. However, shareholder activism became one of the most discussed topics nowadays[145], which should be threatening to the dual-class companies.

"Shareholder activism is a broad phenomenon and corresponds to the various actions undertaken by investors to influence corporate management and boards in order to make corporations change in corporate social responsibility (CSR) or improve their financial outcomes."[146] These are so called general aims of the shareholder activist. Usually, activists believe that these goals can be achieved by changing the Board members, the strategy of the company, initiation of the reorganization or even a split-up of the firm and try to pursue with these ideas. An "activist" can be called any individual shareholder, a group of shareholders or an institutional investor. I would like to stress the importance of the latter. A great amount of all investments are made not by individual investors, but via legal entities, such as pension funds, insurance companies, banks, investment advisors etc. Institutions' investments amounted to 7-8% of market capitalization in 1950's, while in 2010 it increased till about 67%.[147] "The old picture of the publicly traded corporation with widely dispersed individual investors is no longer

[144] Here the term "controlling shareholder" does not mean the biggest shareholder in terms of ownership of stock, but in terms of voting power.
[145] (Foroohar, 2014)
[146] (H. Chung, 2010)
[147] Information taken from the U.S. Securities and Exchange Commission Commissioner Luis A. Aguilar speech, see: (Aguilar, 2013)

accurate."[148] As institutions become the dominant investors, their influential power over the companies they own is also increasing.

Shareholder activism is not a new trend – financial institutions played an important role in US[149] companies' corporate governance already in the early 1900's.[150] However, till 1980's the laws of United States were passed "with the aim of limiting the power of financial intermediaries also prevented them from having an active role in corporate governance."[151] The increased shareholder activism of nowadays was probably influenced by the recent financial crisis, after which investors became more attentive to corporate governance issues that before seemed to be insignificant for them.[152]

How a shareholder shows his activism? Basically, there are two ways:

1) "Vote with his feet", which means selling the shares in case investor is not satisfied with company's performance. "Theoretical and empirical studies provide evidence that the act of selling shares can have disciplinary effects on companies that lead to changes in governance."[153]

2) Try to influence the current management team by presenting proposals, calling shareholder meetings, seeking public contact with the board of directors or management team or simply "naming and shaming".[154] Carl C. Icahn is a perfect example of an activist investor – he buys the shares of companies and engages into pressuring the current management to make changes that he sees necessary to improve company's performance.[155]

It had been noticed lately, that shareholders became more active and want to be involved in the decision making over the most important issues in the company, or for example, nominate the members of the Board.[156] Pressure from investors might force companies to make decisions, which will be orientated to the short-term returns, rather than long-term. That is why

148 (Rock, 1991)
149 We will be concentrating on shareholder activism especially in the United States, because in the previous chapter we also dealt with companies, which are based in the US.
150 (Stuart L. Gillan, 2007)
151 Ibid.
152 (Prial, 2012)
153 (Stuart L. Gillan, 2007)
154 Information taken from European Corporate Governance Institute official web page, see: (Institute E. C.)
155 See: (Economist, 2014) and (Economist, Corporate upgraders, 2014)
156 In the USA, it is still uncommon for the shareholders to nominate the members of the Board, while it is completely normal and understandable in Europe. See: (Davidoff, 2013)

dual-class companies claim that their system helps to focus on future gains, without any worries about price stock fluctuation quarterly. This is a well-known argument that dual-class companies use to justify their stock structure. However, Lucian A. Bebchuk in one of his articles[157] tries to show that this might not be true. He claims that there is no evidence that board insulation will be beneficial in the long run, contrary, the author presents evidence which illustrates that shareholder engagement can and does serve for the long-term interests of the company and its investors.[158] This article, which encourages shareholder activism, received criticism: "Practical realities suggest that Bebchuk's crusade for even more stockholder power may not actually be beneficial to ordinary investors, and that his contention—that further empowering stockholders with short-term investment horizons will not compromise long-term corporate value—is far from proven."[159] As we can see, there are different opinions about the effect of shareholder activism. "Critics often attack the small-bore management and financial changes that activists have typically pushed, saying that they encourage companies to focus too much on the short term. But the truth is that these changes often target real problems at corporations: owning lots of different businesses that have nothing to do with one another, empire-building by C.E.O.s, unnecessarily large cash hoards."[160] Recent study, conducted by Lucian A. Bebchuk, A. Brav and W. Jiang showed that short-term stock price increase after the activists get involved also tend to remain for longer period.[161] Similar conclusion was reached in another study[162], which showed positive effect of shareholder activism. Why shareholder activism usually[163] brings benefits? I would agree with the opinion, expressed by James Surowiecki, who claims that in most of the cases, activists are able to notice the real, existing problems of a particular company. That is why, after the necessary changes pushed by the investors had been made, the stock price starts rising. However, not everyone is so enthusiastic and happy about more "aggressive" and demanding shareholders. "Activist shareholders are destroying companies and causing widespread job losses even at firms that aren't directly targeted, according to leading U.S. corporate lawyer Martin

[157] (Bebchuk, 2013)
[158] Ibid.
[159] (Strine, 2014)
[160] (Surowiecki, WHEN SHAREHOLDER ACTIVISM GOES TOO FAR, 2013)
[161] See: (Wei, 2013). Authors found out that stock price rises in the short-term by 6% when activist investors become involved and this rise is tend to be permanent.
[162] (Klein, 2006)
[163] However, not all activist shareholder attacks brought positive results to the companies and their stockholders. For more information about such failures see: (Surowiecki, WHEN SHAREHOLDER ACTIVISM GOES TOO FAR, 2013)

Lipton."[164] As companies are threatened by the activist' possible attacks, they try to improve the short-term profits by cutting costs, limiting research projects etc.[165] In Lipton's opinion, activists are seeking for short-term returns, which in the long run would weaken the company.[166] Another critic of shareholder activism is Stephen M. Bainbridge, who claims that most commonly the attack against the company is based on the idea that "he or she has better ideas about how to run the company than the incumbents, which may be true sometimes but often, seems dubious. Worse yet, some interventions are intended to advance an activist's agenda that is not shared by other investors."[167] It is important to mention that usually the managers of institutions which invest in certain companies do not have the necessary company–specific knowledge that the insiders have, and it becomes very risky to trust that their view of how to govern the company is correct. "Hedge funds may be able to detect when dividends should be raised, assets should be sold, or acquisitions embraced or rejected. But financiers who second-guess management about the details of company operations may be over-reaching."[168]

Overall, there is no common opinion towards the effect of shareholder activism, but the main fact that had been recognized by everyone is that shareholder activism had increased significantly over last years and their targets became not only small and poorly performing firms, but large and well known corporations as well.

3.2. Opposition from institutional investors

The California Public Employees' Retirement System, or shortly called - CalPERS, is one of the biggest pension funds in the United States, which "provides retirement, health and related financial programs and benefits to more than 1.6 million public employees, retirees and their families and more than 3,000 public employers."[169] More importantly, CalPERS is one of the leading and most influential activists, focused on corporate governance issues.[170] "Without question, it has contributed to many changes in how corporate managements now behave."[171] More importantly, it had been observed that the stock price of the companies that had been

[164] (McFarland, Activist investors destroying companies, costing jobs, top corporate lawyer says, 2013)
[165] Ibid.
[166] Ibid. Also see: (Merced, 2014)
[167] (Bainbridge, 2013)
[168] (Carney, 2013)
[169] Information taken from the official web page of CalPERS, see: (CalPERS)
[170] (A. Junkin, 2009)
[171] Ibid.

targeted by the pension fund tends to rise –"after all, it is improved stock returns from enhanced corporate profitability that is the ultimate purpose of the CalPERS good governance movement.[172] The CalPERS has three sources of funding – money they get from the employers, members (employees) and the profits the fund will get after investing before mentioned contributions.[173] The pension fund with $1.235 billion in total assets[174] can be surely called "one of America's most powerful shareholder bodies"[175]. CalPERS not only invests into companies, but also seek to change their corporate governance in order to improve company's performance and protect fund's investment. "We believe good governance leads to better performance."[176] CalPERS actively participates in legislative reforms in order to improve shareholder protection, for example – the ongoing discussions with the U.S. Securities and Exchange Commission[177], participation in drafting the Dodd-Frank Wall Street Reform and Consumer Protection Act and many more.[178]

As we know, the number of dual-class companies had increased in the last decade, so it was no surprise that the controversial stock structure finally caught the attention of CalPERS too. Back in 2011, the pension fund attacked News Corp, calling its dual-class structure "a corruption of the governance system"[179]. Moreover, Ms. Anne Simpson - CalPERS corporate governance chief - also added, that "Power should reflect capital at risk. CalPERS sees the voting structure in a company as critical. The situation is very serious and we're considering our options. We don't intend to be spectators – we're owners"[180]. Even though the pension fund did not introduce any resolutions in the general meetings of News Corp's shareholders at that time, its promise not to ignore dual-class shares problem was well kept. A year later, the iconic pension fund came back to the plan of eliminating dual-class stock and released the agenda of August 13[181], where it expressed a goal to "address core governance standards of accountability and transparency such

[172] (A. Junkin, 2009)
[173] (Malanga, 2013)
[174] (CalPERS, Facts at a glance, 2014)
[175] (Griffiths, 2004)
[176] Statement taken from the official webpage of CalPERS, see: (CalPERS, Global Governance)
[177] (Pfeuti, 2013)
[178] "Facts at a Glance" CalPERS. June 2012, see: (CalPERS, Facts at a glance: Corporate Governance, 2012)
[179] (A. Edgecliffe-Johnson, 2011) Quoting Anne Simpson.
[180] Ibid.
[181] For August 13 Agenda see: (CalPERS, Agenda Item 7b, 2012)

as removing dual class, classified, or plurality voting structures."[182] According to CalPERS, dual-class shares are entirely bad example of corporate governance destroying shareholder value in the long run. That is why companies which adopt this structure should be avoided by the investors. Some journalists congratulated the promise to boycott dual-class shares, stating that there had been a need of more democracy in corporate governance, which was disrupted by the companies with unequal voting structure.[183]

To make things worse, CalPERS is not the only powerful institutional investor attacking dual-class structure. Let's not forget to add the Institutional Shareholder Services (ISS) "the world's leading provider of corporate governance solutions for asset owners, investment managers, and asset service providers"[184] to the list. ISS had sharply criticized Facebook's stock structure in the research note[185], published in 2012, where it claimed that such corporate governance structure is more likely to "diminish shareholder rights and board accountability."[186] However, it recognized that even though FB's structure should cause "a strong distaste among institutional investors", but it would be hard to diminish the economic success of "one of the hottest business models". Moreover, ISS initiated a study, with which results we had been introduced in the first chapter[187]. Just to remind the reader, this study had revealed many negative sides of dual-class shares. To mention some of them: 1) controlled firms underperform non-controlled ones in the long term; 2) controlled companies face more share price volatility; 3) have more material weaknesses in accounting control and related party transactions than non-controlled ones; etc. These findings were broadly used later by another critic of dual-class structure.

The Council of Institutional Investors (CII) - "a nonprofit association of pension funds, other employee benefit funds, endowments and foundations"[188], that calls itself the leading voice

[182] (CalPERS, Agenda Item 7b, 2012)
[183] (McRitchie, 2012)
[184] Information taken from the official webpage of ISS, see: (Services)
[185] ISS M&A EDGE NOTE: NORTH AMERICA, see: (Services, The Tragedy of the Dual Class Commons, 2012)
[186] Ibid.
[187] Study results are available online see: (ISS, 2012)
[188] Information taken from the official webpage of the Council of Institutional Investors, see: (Council of Institutional Investors)

of corporate governance, also followed CalPERS and ISS example. CII sent letters[189] to NASDAQ and New York Stock Exchange, proposing a rule for approval by the SEC, which would disallow companies to be listed on these stock exchanges if they have two or more classes of common stock with unequal voting rights. Moreover, “companies newly listed on <…> in the future will be prohibited from issuing multi-class stock with unequal voting rights subsequent to their initial listing.”[190] The Council of Institutional Investors strongly believes in one share-one vote principle, bringing the same argument that dual-class shares destroys shareholder value in the long-term (it relies on the study conducted by the IRRC Institute, which we discussed in the first chapter). Contrary to CalPERS, CII claims that it cannot boycott dual-class companies, because some shareholders are simply forced to buy the stock of such firms through passive investment strategies – “With the average Council member indexing approximately 47 percent of its U.S. stock portfolio and approximately 16 percent of its U.S. bonds, our members cannot simply sell their stock in companies with a multi-class stock structure.”[191] However, it strongly supports the prohibition to adapt dual-class structure. As Anne Sheehan, CII chair explained, the existence of unequal voting rights encourages abusive attitude of the board and the insiders, as they are less accountable to the shareholders.[192]

When there is such a strong opposition towards dual-class shares from very influential and respective players like CalPERS, Institutional Shareholder Services, or the Council of Institutional Investors it is surprisingly to see that the stock price of the companies that adopted this structure does not seem to fall. That makes us wonder once again, why investors keep wanting “a piece of pie” in a company which is considered to be a bad example of corporate governance and assumingly destroys shareholder value?

3.3. Short-termism

As we said, dual-class companies claim, that their structure helps to avoid pressure from the investors and concentrate on long-term results. Indeed, given the increased shareholder activism, there is what to fear of. Before the crisis, shareholders did not seem to worry too much about the corporate governance problems, but now their attitude had changed as they are reacting

[189] Letter to the New York Stock Exchange, see: (Investors, 2012) and letter to NASDAQ, see: (Investors, Letter to NASDAQ, 2012)
[190] Ibid.
[191] Ibid.
[192] (Mont, 2012)

more sensitively to any kind of misconduct of the board.[193] Short-termism is an "excessive focus of corporate managers, asset managers, investors, and analysts on short-term results, whether quarterly earnings or short-term portfolio returns, and a repudiation of concern for long-term value creation and the fundamental value of firms."[194]

Shareholder activists claim that their goal is the long-term profits of the company, but the reality seems to be a bit different. Companies are being afraid to become the next target of an activist investor, which is why they try to achieve good results quarterly.[195] "Short-termism is rife on Wall Street: the average time that people hold a stock on the New York Stock Exchange has tumbled from eight years in 1960 to four months in 2010."[196] Of course, we cannot claim that all investors are short-termists, but the fact that holding period dropped so dramatically, indicates that there are significant changes in the market. Indeed, in order to understand them, we should classify institutional investors into three groups, based on their behavior, just like Professor Bushee did[197]:

1) "Transient" institutional investors, which seek short-term profits and use momentum trading, thus usually have small amount of stake in the company.[198]

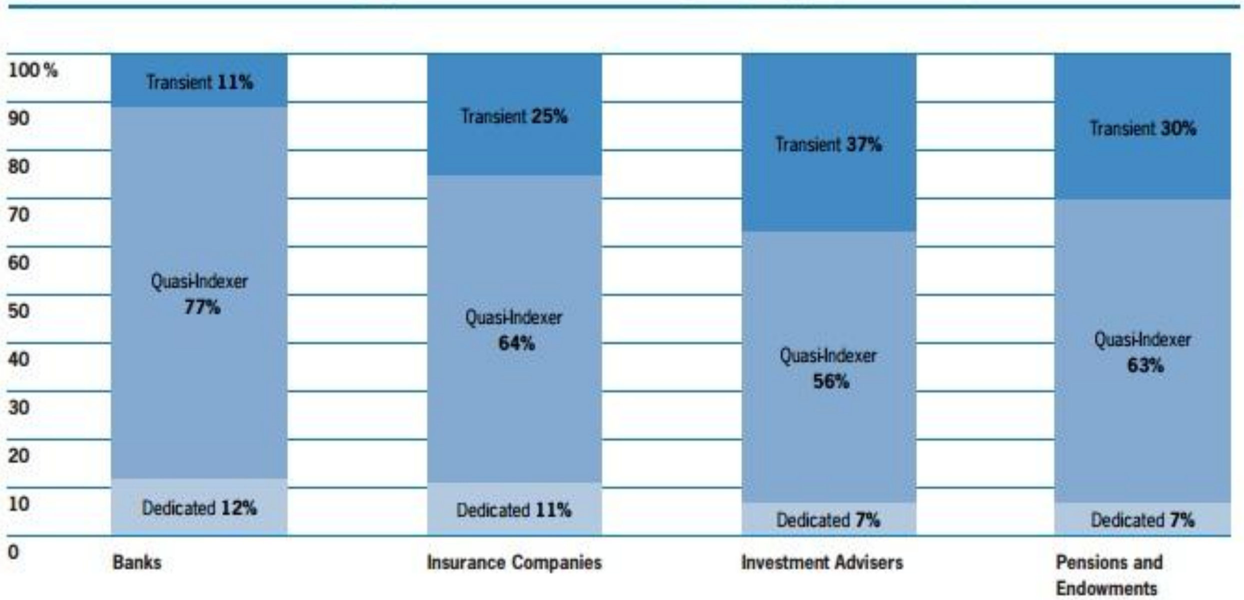
2) "Dedicated" institutional investors, which have investments in several companies, where they hold a significant part of all shares.

3) "Quasi-indexers" that have shares of many companies and hold a remarkable number of shares in almost all of these firms.

In the table visible on the next page, we can see the proportions of each group in the market.

[193] (Prial, 2012)
[194] (Dallas, 2011)
[195] (J. Perella, 2014)
[196] (Economist, Taking the long view, 2012)
[197] (Bushee, 2004)
[198] The grown number of transient institutional investors had been influenced by the emergence of high-frequency trading "Despite efforts at reform, today's markets are wilder, less transparent, and, most importantly, faster than ever before", for more information see: (Baumann, 2013)

Figure 1 Percent of Each Category of Institutional Investors by Legal Type (1983–2002)



Source: Bushee, B. (2004), Identifying and Attracting the "right" Investors: Evidence on the Behavior of Institutional Investors. Journal of Applied Corporate Finance, 16: page 31.

It had been noticed, that "most of the damaging effects of short-termism derive from the behavior of "transient" institutional ownership—and not from "dedicated" institutions or "quasi-indexers"."[199] Short-term results seeking investors cannot perform monitoring function, as they simply do not have time to get to know the company and its environment, their goal is to raise the stock price and sell. That is why the pressure of such investors could be extremely dangerous. As one study[200] showed - the majority of executives of the companies' would cut the costs for research and development or advertising in order to hit short-term targets. Half of these firms that had been interviewed would also delay important projects that could create value in the future. Such horrifying results suggest that we are dealing with short-termism of both sides – the companies and the shareholders. The short-term decisions by the executives are made because of the fear of being replaced. In case investors will not be satisfied with the quarterly earnings, they could either "vote with their feet" or actively engage in pressuring the current management for changes. Both ways can result in the replacement of the manager, which he - of course - tries to avoid. It is very well known that short-termism damages business – "More than three quarters of business leaders believe that the search for short-term corporate profitability in the aftermath of

199 (Pozen, 2014)

200 (John R. Grahama, 2005)

the economic crisis has led to poor leadership decisions that damage business."[201] It had been absorbed that the pressure by short-termists had increased in the previous years[202] that is why the question how we can fight with it became more relevant than ever.

There had been few suggestions how to help the companies and investors to take the long-term view. In order to stop short-termism we have to remove or at least minimize the incentives of seeking quick profits. For example, investors could be awarded with loyalty dividends if they hold stock for a certain period of time. Also, if we tie up remuneration to long-term performance, the executives will be encouraged to "grow" together with the company.[203] Another idea is to "reduce the pressures for short-term decision-making that arise from excessively frequent reporting of financial and investment performance (including quarterly reporting by companies), and from excessive reliance on particular metrics and models for measuring performance, assessing risk and valuing assets."[204] Indeed, this idea had been practically used by Unilever - Anglo–Dutch multinational consumer goods company. Its CEO Paul Polman stopped releasing quarterly profits results after he took over the company in 2009.[205] Moreover, the European Union has plans to eliminate mandatory quarterly reporting from November 2015 too.[206] Dual-class stock structure can be a solution for fighting short-termism too. We had seen in the previous chapter that companies like Google performs exceptionally well and provide investors with high returns, even though it has dual-class shares.[207] Facebook had been so much criticized for its founder's Mark Zuckerberg's sole decision making role; yet, the share price of the company is doing better than good. Dual-class structure enabled these companies to ignore the pressure from investors and focus on what is actually important – the product it produces and the future of the company. More interestingly, some scholars found out that "the value of the firm is negatively affected by longer ownership duration of influential financial and industrial investors. In contrast, the effect is positive the

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[201] (School)
[202] (D. Barton, 2014)
[203] (P. Lamy, 2013)
[204] Ibid.
[205] (Ensor, 2011)
[206] (Chambers)
[207] Google also had to face the shareholder activist John Chevedden attack, who was pushing the company to abandon dual-class structure and give all shares equal voting rights. However, the attempt was unsuccessful. For the source of information see: (McRitchie, Google Insiders Foil Chevedden's Latest Attempt to End Dual-Class Voting, 2013)

longer personal investors own the firm."[208] Basically, this means that the companies, which have few people "in charge" (like all dual-class firms) create more value than the ones that are dominated by institutional investors.

3.4. Conclusion

In this chapter we looked at the current environment in the market, which is relevant to us in terms of how can it influence the future of dual-class stock. We discovered what shareholder activism is, briefly discussed the possible effects it could have and found out about the meaningful increase of activists we had seen lately. While we recognize that shareholders can and should be involved in company's governance, we also stressed a possible threat of shareholder activism going too far and pushing companies to make decisions, which might be destructive in the long-run. As investors are being more active than ever before, we took a look at the recent attacks of CalPERS and the Council of Institutional Investors towards dual-class stock. While these institutions blame unequal voting rights for discriminating other investors and destroying shareholder value, the stock prices of companies which have dual-class structure do not seem to fall, nor lose the attention of investors. That is why we analyzed short-termism of both – companies and the shareholders. As the average stock holding period had decreased significantly, the worries are that shareholders are not interested in firm's long-term performance arise. We recognized the need to fight with short-termism as it is harmful for the company and provided some suggestions how can that be done. One of the ideas being the use of dual-class stock structure.

"To drag the world back to sanity, we need to know why we are here. The answer is: for consumers, not shareholders. If we are in synch with consumer needs and the environment in which we operate, and take responsibility for society as well as for our employees, then the shareholder will also be rewarded."[209] With this brilliant thought in mind, I would like to move on to our final section of this thesis and present the conclusions that I had made based on all the above provided information.

[208] (Ø. Bøhren, 2009)
[209] (Saunders, 2011) Quoting Paul Polman. Steve Jobs is also known for similar thinking.

CONCLUSION

The main aim of this thesis was to introduce the reader with the mechanism of dual-class stock and try to find out if it can be called the new example of "good" corporate governance.

While moving towards the answer to our main question we had briefly discussed what dual-class shares are and find out that their main "function" is to separate voting and cash flow rights, which then allow the insiders of a company to retain control, while having comparatively small amount of total stock. We had revealed that unequal voting shares protect the owners who do not want to give up control, but do want to get the needed financing. As we discussed in the first chapter, this structure receives a lot of criticism for provoking inequality between shareholders, giving the opportunity for the managers to seek private benefits of control and destroying long-term value, as some studies had shown. Nonetheless, we had also seen that dual-class shares cannot be called an entirely bad choice as it has certain advantages too. Dual-class stock can work as a perfect protection against hostile takeovers; "save" the Board of Directors from the pressure of investors who are focused too much on quarterly returns and help the founders of young companies to fulfill their strategic plans.

As many critics claim that minority shareholders are not properly protected in dual-class companies, we also analyzed this issue. It had been noticed that the financial crisis of 2008 at least partially contributed to the disappearance of the "shareholder primacy" rule. In order to stay in the market during those hard times, companies had to innovate fast. Innovation, however, does not come easy and sometimes the Board is forced to make decisions, which might result into temporal stock price fluctuation. This is an unwanted phenomenon for the shareholders, who are sensitively reacting to company's quarterly results. As the controlling shareholder (in terms of voting power) usually has all decision making power for himself, minority shareholder could feel that her interests are not being sufficiently protected. In other words, the Board, or the management team, have less accountability to the shareowners, that is why such companies put shareholder wealth maximization into a "second row", or at least it seems like it. Interestingly, we had find out that nowadays the approach towards shareholders as the owners of the company had changed, that is why shareholder value maximization on the short-term basis is no longer seen as the primal goal of every company. We had also observed that companies which do not see shareholder value maximization as their final goal are the ones that are more likely to achieve it. A perfect example of that is Google – a company with which we became more familiar in the second chapter of this thesis. Google relies entirely on its Board of Directors ability to “predict” what is best for the company. Especially now, when it started issuing the third type of shares – Class C, or shares that carry no voting rights – there is no chance that any outsider would ever be able to overrule decisions made by the current Board of Directors. However, the shareholders do not complain about its corporate governance, as Google is able to provide the shareholders with huge returns. These findings allow us to look at the shareholder protection from a different perspective. Protection of the “weaker” shareholder had always been one of “must have” elements in a company. What we had discovered in this thesis, is that dual-class shares structure does not provide minority shareholders with the protection they were used to get under the traditional “one share-one vote” model. It is true that such a shareholder is forced to “go with the flow”, without the ability to oppose to the decisions of the controlling shareholder or a group of them. However, the evidence presented in this thesis encourages thinking that it is not necessarily a bad thing and can bring benefits for all the shareholders. We had seen that most of the shareowners are not so much concerned about the future of the companies’ they invest in. This is a so called short-termism problem we had discussed in the third chapter of this thesis. As long as shareholders who are interested in quick gains get what they want, everybody seems to be happy and do not complain about stock structure.

Here we come to the main question which this thesis tackles - is it really the corporate governance structure what matters in order to succeed? The second chapter introduced the reader with the real life examples of companies that have dual-class stock structure. This analysis revealed the advantages this structure offers as long with some difficulties it might cause too. We had chosen to discuss how corporate governance is organized in Google, Facebook and Zynga. The analysis had brought interesting results. Our first target – Google – claims that standard “one share-one vote” structure would threaten the independence and objectivity – values that had been of crucial importance to the company way before it went public. That is why Google’s founders believe that adoption of dual-class structure would best ensure company’s ability to innovate and keep its main characteristics untouched. Indeed, things had worked out pretty well for Google, taking into account their current position in the market (which is dominant). The founders would like to thank dual-class stock structure for their success, which helped them to insulate from the pressure of “outside” investors.

Nevertheless, we stressed out the importance of some other elements that the author of this thesis sees as extremely relevant for the overall performance of a company. These elements might not seem very important while looking at Google’s case from the first sight. However, the significance of them becomes clearer when we are confronted with the absence of these elements, which is visible in other companies taking Zynga as the first example. As regards corporate governance, everything in Zynga seems identical to Google – strong leadership, dual-class shares that allow only “the chosen ones” to decide on strategic matters of the company and not to mention all those “cool” bonuses of having a job in Zynga (massages, play-rooms etc.). However, the stock price of the latter had fallen significantly. When looking at the reasons why it happened, we found out that the main cause for the failure was the lack of innovative decisions which would be orientated to future business opportunities (to be more specific here we mean moving more strongly into mobile phones sphere). It had been also observed that the founder Mark Pincus was focused on quarterly results and evaluated the performance of his employees by numbers only. Basically, here we saw short-termism of a company itself. Another problem that was “killing” Zynga was its founder – Mark Pincus. Even though he had a great business idea, created a company and made a lot of money from it, later his decision to adopt dual-class structure turned right against him. “If we lose the services of our founder and Chief Executive Officer or other members of our senior management team, we may not be able to execute our business strategy.” That is what Zynga said before going public. Ironically, company’s stock price went up as soon as it announce about the resignation of Mark Pincus. The new CEO seems to be very keen to improve company’s performance and catch-up with the “train of innovation”. Zynga had demonstrated us that dual-class stock structure is not the only key to success, like Google claimed.

Moreover, looking at the ups and downs of Facebook we can come up with the same conclusion. Remember the biggest crisis this company had experienced right after its IPO (and which lasted almost a year)? Well, the reason for that were the doubts of investors that FB will not be able to move quickly into the mobile platform. Of course, Mark Zuckerberg’s absolute control over the company probably did not inspire much trust either. What kind of conclusion can we draw here? As soon as the market spots a sign of company struggling too long to adapt to the changing needs of the society, the outcome is a falling stock price. The disadvantage of dual-class structure then becomes clearer, as investors are more careful buying stock of such companies.

As we had discussed in this thesis, lately shareholders became more active than ever before. While we recognized that stockholders can and should be involved in company's governance, we also stressed a possible threat of shareholder activism going too far and pushing companies to make decisions, which might be destructive in the long-run. We also said that dual-class shares could help to take precautions against such scenario. However, Influential institutional investors, such as CalPERS, Council of Institutional Investors (CII) and Institutional Shareholder Services (ISS) had expressed strong opposition against dual-class stock companies stating that it destroys long-term value of the firm, weakens Board of Directors' accountability for its actions and in general is "a corruption of governance structure", which should be avoided or even banned.

Every company should have a right to choose which corporate structure it will use, as long as it helps to benefit all interested parties – stockholders and the customers. We had shown in this thesis that dual-class shares can be very beneficial for everyone (Google's example). We had also revealed a lot of negative aspects this structure could have. The author of this thesis finally came up with the conclusion that what works for some companies might not work the same way for others. Corporate structure whether it is dual-class stock or "one share-one vote" does not guarantee business success, nor it can be called "good" or "bad" governance examples. Apart from what the critics say, the author of this thesis does not believe that dual-class companies will cease to exist in the future as there will appear more companies seeking to become "the next Google" or "the next Facebook".

There is no receipt of success – every entrepreneur has to "create" his own, whether dual-class stock will be one of the ingredients does not define the result yet. That is for sure.

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