

## Should Facebook Investors Worry About Lack of Control?

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Anyone buying public shares of **Facebook** will have to accept that the company is almost completely dominated by its founder, Mark Zuckerberg.

Zuckerberg owns Class B shares with 28.2 percent of the voting power of the company, thanks in part to the fact that they are super-shares with 10 times the voting rights of Class A shares. He controls Class B shares with 30.6 percent of the voting power.

All told, that gives Zuckerberg 56.9 percent of the votes on Facebook's board. Which means, effectively, that he has 100 percent control over the company. The public will have no say in the governance of the company.

Facebook's initial public offering registration statement makes Zuckerberg's domination very clear. It spells out that because the company is considered a "controlled company" under securities laws, it doesn't need to have a compensation committee evaluating the pay of management or independent directors on its board. (For now, however, Facebook does have a compensation committee.) This troubles some corporate governance advocates, of course.

"The public has no say in the control of the board, which in my view is terribly harmful to any notion of accountability," Charles Elson, a University of Delaware corporate-governance professor, told **Bloomberg**.

"It's very troubling to investors, and it's a bad bet for them," he said.

That's a view more based in ideology than reality.

Although corporate governance advocates deplore management domination of companies, studies show that,

under certain circumstances, it can actually be a boost to company performance.

In 2004, Harvard Business School professor Belen Villalonga and Wharton School professor Raphael Amit published **"How Do Family, Ownership, Control, and Management Affect Firm Value?"** They looked at proxy filings between 1994 and 2000.

What Villaonga and Amit discovered was that so long as the founders were in charge of the companies — rather than his or her descendants — they outperformed companies not dominated by founders. In other words, the data suggest that shareholders probably do not need to worry about Zuckerberg's domination of Facebook. They should welcome it.

These findings have been confirmed over and over again. A 2007 **study** by Rüdiger Fahlenbrach, of Ecole Polytechnique Fédérale de Lausanne and the **Swiss Finance Institute**, looked at 11 percent of the largest public U.S. firms headed by a CEO who founded the firm. What the study found is that founder CEO firms have shockingly high returns when compared to relevant benchmarks. An value-weighted portfolio of CEO dominated firms would outperform by 10.7 percent, while an equal weighted portfolio would outperform 8.6 percent, the study showed.

"Founder-CEO firms invest more in R&D, have higher capital expenditures, and make more focused mergers and acquisitions," Fahlenbrach found.



A **study** by a pair of Italian economists found similar results that challenged the idea that shareholders should be wary of these companies.

"Valuation and operating performance are significantly higher in founder-controlled corporations," Roberto Barontini and Lorenzo Caprio concluded after looking at data from 675 publicly traded corporations in 11 European countries.

A **study** published in the *Journal of Corporate Finance* in 2008 looked at 275 German exchange-listed companies. It found that founder-run and founder-dominated firms are more profitable than widely held firms.

Founders even outperform professional chief executive types.

According to a **study** in the *Journal of Business Venturing*, founder CEOs tend to earn smaller incentive compensation and smaller total compensation than professional CEOs — suggesting that they are less likely to abuse their position by self-dealing. Zuckerberg, for example, has not been paying himself very much as CEO of Facebook. And next year he's taking compensation of just one dollar.

"Founder-managed firms are associated with higher financial performance and are more likely to survive than professional-managed firms. Firms with founder-CEOs are associated with even higher financial performance when the position of CEO and chairperson of the board is combined," the study concludes.

The evidence in favor of founder-dominated firms is so robust it is surprising that it isn't properly priced into the shares. After all, if having a founder running the company is so valuable, shouldn't investors bid up share prices so as to eliminate the arbitrage opportunity from the performance advantages?

Why isn't there a founder premium already built into the share price?

It may be that investors overestimate the value of "good" corporate governance, perhaps because the experts are constantly warning that lack of shareholder rights or independent directors is so dangerous.