The Washington Post

Back to previous page

# In Facebook IPO debacle, Wall Street prevails

**By Allan Sloan,**

When Mark Zuckerberg's stated mission to connect and empower people collides with Wall Street's actual mission, which is to empower and enrich the well-connected, guess which mission prevails? Wall Street's, hands down. That's the lesson we can take from the debacle of Facebook's initial public stock offering.

It's really sort of funny, if you're into dark financial humor. Facebook and its underwriters, led by Morgan Stanley, whipped up enthusiasm for the offering, whose initial price range was $28 to $35 a share, but ultimately was increased to $38. Buyers were salivating. The buzz about the offering was deafening.

Then, at the last minute, some big investors were reportedly given access to an analysis saying that the company's prospects weren't quite as rosy as the picture painted in its early disclosure documents. So the big guys, it appears, cut back or even canceled their orders to buy shares in the offering. This late-in-the-game burst of activity may even have had something to do with the Nasdaq foul-up that roiled trading last Friday, the day the stock debuted.

The exit of the well-connected, combined with an increase in the number of shares being offered, left more shares available for individual investors, who paid the full retail price of $38. Then, they got to watch the stock's sickening slide. As I write this, Facebook is trading 16 percent below its initial offering price. A pretty nasty three-day loss.

The well-connected who canceled their IPO orders — all of which, I'm sure, is perfectly legal on everyone's part — have had a chance to buy stock in the low $30s rather than at $38. Retail investors who were dreaming of riches and figured they were lucky to be able to buy at the offering price have gotten bagged for more than $6 a share. Even though they may not have actually sold at a loss, they paid $38 Friday for stock they could have bought at less than $32 today. The numbers are even worse for people who bought shares in the open market at prices in the $40s, on the first day of trading.

Who benefited from the way the offering has played out? Primarily, the early Facebook shareholders who cashed out in the offering. According to the most recent available document, early Facebook investors ranging from Zuckerberg to Microsoft to various venture capital funds sold a total of 241.2 million shares in the offering, compared with only 180 million shares sold by the company itself. It's unusual to see early investors selling this big a piece — 57 percent — of the shares being peddled in an IPO.

During the weeks that the Facebook offering was pending, we saw a steady increase in the number of shares being offered by insiders — all of whom by definition are well-connected. In its May 3 filing, the first with specific numbers, Facebook said insiders would sell 157.4 million shares. They wound up selling an additional 83.8 million shares — the company's piece of the offering remained where it had been originally set, at the aforementioned 180 million shares.

What's more, the sellers got an extraordinarily cheap deal from the underwriters, probably because of incredible pressure that Facebook exerted by shopping the deal to firms who were drooling over the prospect of having their name connected with Facebook's.

The "underwriting discount" — the amount that the underwriters kept for themselves in return for doing the deal — was only 1.1 percent of the $38 offering price, which is extraordinarily low for an initial public offering. By contrast, the discount for Zynga's offering was 3.25 percent, according to S&P Capital IQ, and was 6 percent for Groupon and 7 percent for Zillow.

This means that Facebook insiders who sold in the offering not only got a high price for their shares, but they also got to keep an extraordinarily large portion of the proceeds.

I'm not saying any of this is illegal — I'm sure that lawyers have blessed every aspect of this, including any selective disclosure to big players that Facebook's numbers were starting to look a little ugly.

The bottom line: It's one thing to talk about empowering average people in the Facebook world. But empowering them in the financial world is a whole different game.

*With research assistance by Doris Burke of Fortune.*

Sloan is Fortune magazine's senior editor at large. To read his previous columns, go to postbusiness.com.