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The Present and Future of Corporate Governance: Re-Examining the Role of the Board of Directors and Investor Relations in Listed Companies

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May 2013

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The authors would like to thank the participants of the OECD Roundtable on Corporate Governance, Value Creation and Growth in Istanbul on 1 February 2012, the participants of the 7th ECFR Symposium in Luxembourg on 28 September 2012, the participants of the 2012 OECD-Asian Roundtable on Corporate Governance in Tokyo on 24-25 October 2012, the participants of the Business Law and Practice Seminar Series at the University of Leeds on 29 January 2013 and the participants of the PTTP Putting Theory to Practice International Speakers Series & Osgoode Society for Corporate Governance Lecture on Corporate Governance and Innovation: Should Facebook's Governance Structure Scare Investors? in Toronto on 26 February 2013 for their comments and input. A special thank you goes to William Bratton, Douglas Cumming, Janke Dittmer, Mark Fenwick, Jill Fisch, Michael Galanis, Koen Geens, Ronald Gilson, Mats Isakson, Fianna Jurdant, Grant Kirkpatrick, Marco Langendoen, Amir Licht, James Mawson, Jose Miguel Mendoza, Alessio Pacces, Caslav Pejovic, Daniel Puchniak, Theo Raaijmakers, Francisco Reyes, Jun Saito, Stephen Seuntjens, William Stevens, Zenichi Shishido, Leo Strine Jr., Christoph Van der Elst, Dirk Zetzsche, and Peer Zumbansen for their discussions and input on the ideas that appear in this paper.

Abstract

In this paper, we first shed light on the factors that underlie the differences between the 'shareholder wealth maximization' and the 'long-term commitment' models of corporate governance. By introducing a third type of governance model, we show that a three dimensional approach provides a better understanding of the dynamics of corporate governance practices. The examination of the three-dimensional model's focus on growth and value creation provides a powerful catalyst for companies implementing a well-functioning governance structure. Our analysis is supported by case studies of, for instance, Facebook and LinkedIn that illustrate how shareholder value and long-term commitment are very much affected by a firm's growth and innovation prospects. The second part of the paper provides important insights into practices and strategies that could promote growth and value creation in listed companies. We show that it is a daunting task to define best practices. However, we use two hand-collected data sets that consist of (1) seventy venture capital backed companies that were involved in IPOs on US stock markets between 2011 and the first half of 2012, and (2) the top-forty of the world's largest companies in the Financial Times Global 500 2012 List to show how board dynamics can give companies a clear competitive advantage. To gauge the importance of an innovative investor relations' strategy as an important condition for firm performance, we examine the impact of establishing frequent and timely interactions with investors.

Keywords: Board of Directors, Corporate Governance, Diversity, Economic Growth, Entrepreneurship, Facebook, FT Global 500, Initial Public Offerings, Investor Conferences, Investor Relations, Long-Termism, Principal Agency Theory, Short-Termism, Value Creation, Venture Capital

JEL Classifications: G34, K20, K22, L21, L25, L26, O16

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In this paper, we first shed light on the factors that underlie the differences between the 'shareholder wealth maximization' and the 'long-term commitment' models of corporate governance. By introducing a third type of governance model, we show that a three-dimensional approach provides a better understanding of the dynamics of corporate governance practices. The examination of the three-dimensional model's focus on growth and value creation provides a powerful catalyst for companies implementing a well-functioning governance structure. Our analysis is supported by case studies of, for instance, Facebook and LinkedIn that illustrate how shareholder value and long-term commitment are very much affected by a firm's growth and innovation prospects. The second part of the paper provides important insights into practices and strategies that could promote growth and value-creation in listed companies. We show that it is a daunting task to define best practices. However, we use two hand-collected data sets that consist of (1) seventy venture capital backed companies that were involved in IPOs on US stock markets between 2011 and the first half of 2012, and (2) the top-forty of the world's largest companies in the Financial Times Global 500 2012 List to show how board dynamics can give companies a clear competitive advantage. To gauge the importance of an innovative investor relations' strategy as an important condition for firm performance, we examine the impact of establishing frequent and timely interactions with investors.

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I. Introduction

Facebook: 'like' or 'dislike'? The answer inevitably depends on to whom you pose the question. When we ask students the answer more than 90 percent is yes! Explaining the reasons for their enthusiasm is simple. Facebook offers an almost unlimited platform for sharing information. Not only does it allow students the option to share pictures, videos and stories with family and friends, but it also provides them with a great tool to virtually and interactively engage with other students in group discussions and course assignments. There are other reasons why Facebook is so much liked by its users. For instance, it helps promote businesses (if it is able to gather a significant number of 'likes' and hardly any 'dislikes').[4] Moreover, it is a place where people can find entertainment, such as games, photo editing and other creative and engaging apps. Perhaps most importantly, Facebook is fun. Employees of the social media company also agree. Facebook was rated as the Best Place To Work in 2013.[5] The company scored a 4.7 out of 5 rating.[6] In addition, 97 percent of 388 Facebook employees that participated in the survey approved of the chief executive officer (CEO) Mark Zuckerberg.

[4] See V Schöndienst, F Kulzer and O Günther, "Like versus Dislike: How Facebook's Like-Button Influences People's Perception of Product and Service Quality", ICIS (International Conference on Information Systems) 2012 proceedings.
[5] See M McGee, "Stock Price Be Damned! Facebook Is Top Company on 'Best Place to Work 2013' List", Marketing Land, 12 December 2012.
[6] See Glassdoor's fifth-annual Employees' Choice Awards, www.glassdoor.com - updated on 9 April 2013.

Not everybody is enthusiastic about Facebook.[7] There are a substantial number of people whose reputations, relationships and businesses may have been harmed by a Facebook posting. Most of these issues, however, boil down to privacy and confidentiality matters and settings.[8] Then there are the investors in Facebook. What are their views of Facebook? Well, this depends very much on when the investments were made. Founder Mark Zuckerberg and early employees have derived big gains from Facebook's initial public offering (IPO) at the NASDAQ in May 2012. Also, early stage investments by angels and venture capital funds in Facebook have been highly profitable.[9] For example, angel investor Peter Thiel, who is considered Facebook's first big investor, made an investment of US$ 500,000 and received approximately a 10 percent stake in the company in 2004.[10] This investment estimated returning more than 2,000 percent based on private transactions before the IPO, a sale of 16.8 million common shares during the IPO in May 2012 (for a total of about $638 million) and 20.1 million common shares after the expiration of a lock-up period in August 2012 (for a total of $396 million).[11]

In some quarters, investors who acquired shares on SecondMarket, SharesPost or other private secondary markets before the IPO have every reason to dislike Facebook.[12] Initially traded on SecondMarket at an implied valuation of $14.70 billion (and a share price of $6.39) in January 2010, Facebook's value had reached $56 billion by December 2010 following transactions carried out on SharesPost. The SecondMarket transactions just prior to the IPO were executed at an implied valuation of $90.13 billion (and a share price of $36.05) in March 2012, an increase of more than six times in a little more than two years.[13] It was widely expected that Facebook would be one of the most successful IPOs in the history of stock markets in the United States.[14] And, as expected, the IPO was priced at $38 per share, at which price Facebook raised an amount of $16 billion – making it the third largest US IPO ever.[15]

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[7] See S Hepola, "When a Facebook Friend Turns Enemy", BloombergBusinessweek, 25 February 2013.

[8] See A Roosendaal, "Facebook Tracks and Traces Everyone: Like This!", Tilburg Law School Legal Studies Research Paper Series No. 03/2011. See also J Guynn, "Facebook Feature to Promote Friends' Posts Raises Privacy Issues", The Los Angeles Times, 15 February 2013; M Kosinski, "Facebook Likes Show Big Data Brings Big Responsibility", The Financial Times, 15 March 2013.

[9] See www.whoownsfacebook.com.

[10] See O Thomas, "Now Peter Thiel Has Handed His Facebook Shares to Investors", Business Insider, 25 February 2013. The investment was initially made in the form of a convertible note and later converted into an equity stake. Peter Thiel's investment diluted down to approximately 3 percent in February 2012. See K Eaton, "The Facebook IPO Players Club: Peter Thiel (Updated)", Fast Company, 1 February 2012.

[11] See S Raice, "Early Facebook Investor Peter Thiel Unloads Stake", The Wall Street Journal, 20 August 2012.

[12] See JM Mendoza and EPM Vermeulen, "Towards a New Financial Market Segment for High tech Companies in Europe" in H Birkmose, M Neville and KE Sørensen (eds.), *The European Financial Market in Transition* (The Hague: Kluwer Law International, 2011).

[13] Based on information from www.secondmarket.com.

[14] S Raice, "Facebook Sets Historic IPO", The Wall Street Journal Technology, 2 February 2012.

[15] J Pepitone, "Facebook's IPO price: $38 per share", CNNMoney Tech, 17 May 2012.

On 18 May 2012, trading of Facebook's shares at the NASDAQ opened at a promising $42.05 per share, but the IPO failed to generate the generally expected high first-day return.[16] Empirical research analyzing 2,634 venture capital backed IPOs from 1980 to 2010 shows that the average first-day pop is 27.9 percent.[17] The mere 0.6 percent 'pop' at Facebook clearly also disappointed a large number of investors who bought at the offering or acquired shares through pre-IPO stage private transactions.[18] To be sure, if it weren't for the investment banks that acted as lead underwriters in this IPO, the disappointment would even have been much greater. It turns out that underwriters allegedly used their option to buy additional shares from Facebook (known as the 'green shoe' or overallotment option) to oversell to their clients. This is widely accepted by participants in the financial market. If an offering generates the expected first day return, the underwriters may cover the oversold shares by exercising their option to purchase additional shares from the company at the original issue price. If, however (as in the case of Facebook), there is a chance that the stock shows a negative first day return, the underwriters may choose to stabilize the stock price by buying the stock they initially oversold in the market.[19] In this case, it is obvious that particularly retail investors were misled by the overvalued IPO price and were immediately lined up to sell their shares.[20] Unfortunately for these investors, the 'green shoe' mechanism could not prevent a further drop of Facebook's stock price after the first trading day. Ultimately, the deteriorating post-IPO share price performance has ensured that Facebook will be cited in the history books of IPOs – although not in the way most investors had expected.[21]

Remarkably, Facebook's disappointing IPO worked precisely as corporate governance experts have predicted. When Facebook announced that it would adopt a similar governance structure as other recently listed social media companies, such as Groupon and Zynga, they already warned investors that the immediate creation of shareholder value is not the main priority for Facebook.[22] The much-cited issuance of multiple voting shares provides Facebook's founder Mark Zuckerberg with voting control in excess of his stake in the company. Indeed, he owned approximately 28 percent of his company following the IPO, but the dual class share structure allowed him to exercise 56.9 percent

[16] See S Kim, "Facebook IPO: 'FB' Stock Closes Close to IPO Price But Still Biggest U.S. Tech IPO", abcNEWS, 18 May 2012; B Bailey, P Delevett and S Johnson, "Facebook IPO Huge, But No 'Pop', Mercury News", 18 May 2012; L Cowan, "IPO Analysts Unified on Facebook Pop But Warn of Risks", Financial News, 15 May 2012.

[17] See JR Ritter, Initial Public Offerings: VC-Backed IPO Statistics Through 2012, 4 January 2013. See also J Ashkenas, M Bloch, S Carter and A Cox, "The Facebook Offering: How it Compares", The New York Times DealBook, 17 May 2012.

[18] See S Raice, R Dezember and J Bunge, "Facebook's IPO Sputters", The Wall Street Journal Technology, 18 May 2013.

[19] See T Worstall, "Explaining Facebook's IPO: The Greenshoe", Forbes, 22 May 2012.

[20] See G Morgenson, "Facebook Gold Rush: Fanfare vs. Realities", The New York Times, 19 May 2012; B Womack and A Thomson, "Facebook Tumbles Below IPO Price on Second Day of Trading", Bloomberg, 21 May 2012.

[21] See H Moore, "Facebook's IPO Debacle: Greed, Hubris, Incompetence…", The Guardian, 23 May 2012. Facebook's IPO performance after 30-days was -21 percent. The 60-days and 6 months performances were -26 percent and -38 percent respectively.

[22] See T Johansmeyer, "Facebook: Corporate Governance Minefield", Business Insider, 2 February 2012.

of the voting power, thereby curtailing shareholder rights and reducing the influence of the board of directors. Yet, the question remains whether the elimination of Zuckerberg's autocratic governance structure (by converting his multiple voting shares into common shares) will significantly affect Facebook's IPO performance.

There is no easy answer. If you ask advocates of the conventional, 'old school' corporate governance model, they will point at the agency problem between Mark Zuckerberg and the public investors. They see no reason why Zuckerberg should be allowed to operate without the traditional legal mechanisms and institutions that incorporate monitoring mechanisms and ensure managers select high net present value projects.[23] Despite the conventional corporate governance theory, recent research on governance mechanisms suggests a more germane perspective. Alternatively, less conservative experts look beyond the one-dimensional model of controlling managerial misbehavior and increasing shareholder/stakeholder value. They propose a long-term investment strategy supplemented by institutional constraints and shareholder activism. In developing their theory, the rationale for adding another dimension to the principal-agent model[24] is to establish and safeguard long-term commitments and trust within the company. Dual-class share structures may be necessary to enable the founders of high potential growth companies to focus on long-term sustainable growth while offering resistance to the short-term attitude of the stock market.[25] Thus, in the case of Facebook, this means that shareholders should realize that they invest in Mark Zuckerberg and surrender themselves to the long-term commitment and focus of Facebook's founder. In this instance, as in others, shareholders should presumably gain comfort from the high satisfaction rates among the company's most important stakeholders, its users and employees.

If we accept a two-dimensional model of corporate governance, the Facebook-case suggests there remains a conundrum. Corporate governance mechanisms that are designed to align the long-term interests of Facebook's stakeholders (its employees and its increasing number of users) and the short-term interests of the investors appear to be inconsistent and mutually exclusive. A further difficulty may arise in the limited availability of methods of incentivizing long-term investors. Mindful of this, we use the analysis of Facebook and other growth companies to develop a new

[23] See A Fontevecchia, "Zuckerberg A Dictator? ISS Blasts Facebook's 'Autocratic' Governance", Forbes, 14 February 2012.

[24] See, for instance, C Mayer, *Firm Commitment, Why the Corporation Is Failing Us and How to Restore Trust in It*, (Oxford: Oxford University Press, 2013). See also IM Millstein, "Re-Examining Board Priorities In An Era Of Activism", New York Times DealBook, 8 March 2013.

[25] See Schumpeter, "Taking the Long View", The Economist, 24 November 2012. Somewhat surprisingly, private investors, such as angel investors and venture capitalists, increasingly and actively support dual class share structures. They believe that high frequency and algorithmic trading, short-term holding periods, fragmentation and dark pools that characterize today's stock markets are factors that justify the issuance of multiple vote shares to the founders of the company. Without the dual class stock protection, a high potential growth company that decides to raise capital from public markets would distracted by the significant challenges of casino-type environment of the stock exchange. See JS Lublin and SE Ante, "A Fight in Silicon Valley: Founders Push for Control", The Wall Street Journal, 11 July 2012.

theory of corporate governance that we already observe in practice. The theoretical argument presented in this paper suggests that a three-dimensional model, in which the focus on future growth and value creation is key, help resolve the corporate governance dilemma resulting from the imbalance between short-term investment strategies and a long-term outlook. Unfortunately, much prior research on the governance structure of firms ignored the role of growth and value creation.[26] This is problematic because our research demonstrates here that shareholder (and stakeholder) value and long-term commitments are very much interrelated with a firm's growth and innovation prospects. To get a sense of the intertwined dynamics between the three dimensions of corporate governance, consider the IPO of LinkedIn, another social media company.

Similar to Facebook, the most controversial part of LinkedIn's corporate governance structure is its use of multiple-voting shares. Following its IPO on 18 May 2011, co-founder Reid Hoffman together with the key venture capital investors held Class B shares, which gave them 10 votes per share. Class A shares with 1 vote a piece were offered to the public. From the perspective of the one-dimensional corporate governance model, the practices reinforce the power of controlling shareholders and therefore are unacceptable.[27] As it turns out, Reid Hoffman, who is also the chairman of the board of directors of LinkedIn (and part-time partner at a venture capital firm in Silicon Valley), held (directly or indirectly) a minority stake of approximately 16.3 percent of the outstanding Class A and Class B shares, but controlled approximately 61.5 percent of the voting power on 31 December 2012.[28] Still, the alleged corporate governance weakness had not held back investors' interest.[29] A plausible explanation for this is that investors usually suffer from myopia, paying little attention to details.[30] However, in the case of LinkedIn, their short sightedness gave them windfall profits.[31] Was it just luck (the comparison between stock markets and casinos is often made) or something else? Let's turn again to a comparison of LinkedIn with Facebook.

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[26] In general, the corporate governance debate offers a single-minded analysis and overemphasizes the importance of risk-management and remuneration policies, the engagement of shareholders and independence of directors. Interestingly, however, the OECD Principles of Corporate Governance (2004) explicitly states in its preamble that '(t)o remain competitive in a changing world, corporations must innovate and adapt their corporate governance practices so that they can meet new demands and grasp new opportunities.' It is therefore not surprising that in the aftermath of the financial crisis, the OECD launched an initiative to refocus the corporate governance discussion on value creation and growth. See OECD (2012), *Corporate Governance, Value Creation and Growth, The Bridge between Finance and Enterprise*, (Corporate Governance, OECD Publishing, 2012).

[27] See J Plender, "We Will Rue Our Failure to Govern the Social Networks", The Financial Times, 15 May 2011.

[28] See C Loizos, "LinkedIn: One Class of Stock Too Many", PEHUB, 3 February 2011.

[29] See M Boslet, "LinkedIn's Dual Stock Structure Doesn't Seem to Hold Back Investor Interest", PEHUB, 18 May 2011.

[30] See J Plender, "A Long History of Myopic Investing", The Financial Times, 15 May 2011.

[31] LinkedIn's IPO performance after 30-days was 46 percent. The 60-days and 6 months performances were 144 percent and 60 percent respectively.

In contrast to Facebook, LinkedIn had compelling and sustainable growth prospects.[32] While Facebook experienced an expected growth in its mobile products without being able to monetize on it, LinkedIn quickly became the dominant social media tool for professional networking.[33] More importantly, companies increasingly use LinkedIn's paid recruitment service to find and select talented employees.[34] LinkedIn's actual growth forecast (more than its current financial performance) distinguishes it from its peers. Its users love its products. Moreover, LinkedIn achieved a top-5 position in ranking of the best tech companies to work for in 2013.[35] Notice that its CEO, Jeff Weiner, received a 91 percent support from the employees. What is most interesting is that its stock price had soared by more than 150 percent on 31 December 2012, satisfying both short-term and long-term investors. But, as our research will show below, growth in itself is not sufficient. Thus, in order to ensure that short-term and activists investors do not 'interfere' with long-term sustainable growth, LinkedIn understood that it is crucial to accurately and consistently communicate with both retail and institutional investors about its business model, product development, economic impact and, most importantly, its growth prospect.[36] Furthermore, LinkedIn's well-functioning investor relations and corporate communications service has built to an effective capital markets strategy which is reflected in its positive IPO performance, suggesting that a clear communication of a company's growth prospect is one of the most important elements in the three-dimensional corporate governance model.[37]

As in prior research, we use case studies (and two hand-collected data sets) in this paper to challenge current thinking about corporate governance. Two controversial inferences seem to arise from the case studies. First, companies, particularly their executive managers and board of directors, are partially responsible for the short-term mentality within companies and the investor community. For our purposes, however, they are also part of the solution. For instance, if we for now assume that the basis for generating an abundance of long-term investor interest is a compelling financial performance supported by future growth and a robust innovation pipeline, it is evident that the companies' potential and intentions should be communicated clearly and effectively to the financial (and product) market.[38] The information enables investors to learn about the firm, its members and

[32] See A Tsotsis, "So Why Is LinkedIn an IPO Standout?", TechCrunch, 30 May 2012.
[33] See EM Rusli, "LinkedIn: The Ugly Duckling of Social Media", The Wall Street Journal, 27 February 2013.
[34] See M Overell, "How LinkedIn Is Eating the Recruitment Industry", ere.net, 24 October 2012.
[35] See M McGee, supra n 5.
[36] Another example of how the stock market and its investors are interested in future growth and innovation is Intel. Its stock was down -14.97 percent over the past 52-weeks on 31 December 2012, because it had not fully embraced the shift to tablets and smartphones (and kept focusing too long and too much on the declining PC industry). See A Mahmudova, "Tech Stock Fall Out of Favour", The Financial Times, 21 January 2013.
[37] See N Stewart, "The Good and Bad of IRO 2.0", Inside Investor Relations, 26 March 2012.
[38] This conclusion is supported by empirical evidence indicating that firms also make use of product market advertising in attracting interest for new equity issues. See T Chemmanur and A Yan, "Product Market Advertising and New Equity Issues", (2009) 92 Journal of Financial Economics 40.

the potential for growth. But, the failure to do so may 'activate' the demands of investors and corporate governance experts to pursue short-term goals. Short-term mechanisms, such as negative media attention and short selling activities, are then employed to propose stricter control mechanisms on corporate executives, corporate reorganizations, increased dividends and stock buybacks. Once investors are committed to such a strategy, the usual result is that the company ends up in a vicious circle of one-dimensional corporate governance discussions, making it extremely difficult to recapture the focus on growth, innovation and value creation.

The second inference that arises from the examples is that academics, policymakers and practitioners must be careful in deriving conclusions about the most effective corporate governance or ownership structure. This paper will argue that investors and other stakeholders appreciate diversity in corporate governance structures when it is related to future growth, innovation and value creation. In particular, different governance structures and organizational formulas are required to provide for the entrepreneurial environment that allows companies to execute on strategic plans, develop innovative products and/or enter new markets. These requirements are firm specific and vary across life cycle stages, sectors, regions, countries and cultures. Our analysis reveals that an entrepreneurial governance structure is dynamic in that it will change over time according to shifting business practices, altering ownership structures, evolving markets and so forth. Taking this view one step further, we argue that in the three-dimensional corporate governance model, tailor-made structures and mechanisms play an important role in improving the overall attractiveness and competitive strength of a company.

The remainder of this paper is organized as follows. Section 2 further develops and explains the theory of the three-dimensional corporate governance model. It argues that issues about ownership structures, board compositions and shareholder engagement should be discussed against the background of a company's growth and value creation potential. Section 3 uses this model to analyze and assess the corporate governance structure of Facebook and other social media companies. Interestingly, social media companies that recently went public generally adopted dual class share structures that allowed the founders a tight post-IPO grip on control, but the IPO performance have been mixed. How can we explain these different results? We show that market perceptions of firms' growth potential have a significant impact on the IPO and stock price performance. In order to make an appropriate assessment, Section 3 then empirically tests the three-dimensional model by analyzing hand-collected data sets that consist of (1) seventy venture capital backed companies that were involved in IPOs at US stock markets between 2011 and the first half of 2012, and (2) the top-forty of the world's largest companies in the Financial Times Global 500 2012 list.[39] Even though there is empirical evidence supporting the importance of tailor-made corporate governance structures, an analysis of the data provides some insights in practices and strategies that may give companies a competitive advantage in their efforts to develop innovative products and services, attract and retain talent and build long-termism in their decision-making processes. Section 4 concludes.

II. The Theory of the Three-Dimensional Model of Corporate Governance

1. Re-Examining Corporate Governance Models in an Era of Short-Termism

The short-term orientation of investors and corporate boards is currently one of the key challenges in the corporate governance debate.[40] In the main, policymakers, practitioners and academics alike hold strong views that investors' emphasis on stock market liquidity, evidenced by the growing high frequency and algorithmic trading activity and short-term holding periods, encourages a focus on short-term results.[41] It should therefore come as no surprise that technology entrepreneurs, particularly if there has been a lot of hype surrounding their possible IPOs (which has been the case for companies in the area of social media),[42] increasingly prefer to stay private as long as possible or choose to structure 'their' listed companies in such a way that investors and board members are not able to unseat them after the initial public offering (IPO).[43] Indeed, empirical research already shows that technology companies going public not only tend to be older, but also are more likely to have dual class share structures.[44] By giving the founders controlling voting power in excess of their cash-flow rights, these structures allow founders to resist pressures of public investors to produce short-term results and forego investments in new products.[45]

It is widely believed among one-dimensional corporate governance experts that heavy control by insiders is likely to deter investors. To support this view, they cite to the disappointing IPO performances of social media companies, such as Facebook, Zynga and Groupon, which all had a negative IPO performance after 6 months of -38 percent, -44 percent and -50 percent respectively.[46]

[39] We have excluded energy, oil and gas producers and financial institutions from the dataset.
[40] See, for instance, C Mayer, supra n 24.
[41] See L Stout, *The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public* (San Francisco: Berret-Koehler Publishers, Inc, 2012).
[42] This is evidenced by the fact that these companies had already attracted a lot of followers as non-listed companies on private secondary markets, such as SecondMarket and SharesPost.
[43] See "Rival Versions of Capitalism, The Endangered Public Company, the Rise and Fall of a Great Invention, and Why It Matters", The Economist, 19 May 2012.
[44] See JS Lublin and SE Ante, "A Fight in Silicon Valley: Founders Push For Control", The Wall Street Journal (Technology), 11 July 2012.
[45] See Schumpeter, "Taking the Long View", The Economist, 24 November 2012.
[46] See J Plender, "Lessons in Control for the Tech IPOs", The Financial Times, 7 October 2012.

A number of alternative explanations for these underwhelming IPOs are offered. First, restrictive control rights make founders (and early investors) prone to tunnel vision. Second, and even worse, dual class share structures provide ample opportunity for insiders to act self-interestedly at the expense of other investors and stakeholders.[47] Consequently the experts point out that in order to enhance shareholder value, it is important for listed companies to create a level playing field for investors by having only one class of common stock outstanding.[48] Such a level playing field arguably increases insiders' accountability and adherence to generally accepted corporate governance mechanisms.[49] Clearly, this is particularly the case if the founders (and/or other early investors) do not form a considerable voting block in the company, making them more susceptible to activist investors and hostile bids.[50] The theme across this explanation is that a level playing field is expected to reduce the agency problems between public shareholders and stakeholders on the one hand and the founders and early investors on the other.

Again this brings us back to the issue of short-termism in listed companies. The corporate governance reforms that followed in the wake of the 2001-2002 corporate failures were mainly initiated to align the interests between managers and the often-passive investors by focusing on the independence and composition of the board of directors, auditing and remuneration processes, risk-management systems and strict disclosure rules.[51] But if we believe that investors are generally more concerned with a company's stock price and short-term performance, a strict adherence to a corporate governance framework that protects the 'short-term' interests of investors may have the counterproductive effect of eroding long-term growth and innovation in listed companies. Unsurprisingly, therefore, policymakers, convinced that the short-term attitude of investors played a significant role in the financial crisis of the late 2000s, have 'again' attempted to fix the shortcomings of the corporate governance framework by promoting measures that encourage long-term shareholder engagement.[52] At first sight, these recent corporate governance reforms appear to be successful. Consider the effect of the rules regarding the advisory 'say-on-pay' votes introduced by the Dodd-Frank Act in the United States.[53] Modern thinking shows that these rules have indeed encouraged executive managers to enter into a dialogue with the investors and their proxy advisors

[47] See A Scaggs, "Investor Group to Exchanges: Stop Dual-Class Listings", Wall Street Journal, 11 October 2012.
[48] See M Arnold, "One Share, One Vote Must Be Left Alone", The Financial Times, 25 January 2013.
[49] See IRRC Institute and ISS, "Controlled Companies in the Standard & Poor's 1500: A Ten Year Performance and Risk Review", October 2012.
[50] See WW Bratton and JA McCahery, "Incomplete Contracts Theories of the Firm and Comparative Corporate Governance", (2001) 2 Theoretical Inquiries in Law 745.
[51] See R Kraakman et al, *The Anatomy of Corporate Law, A Comparative and Functional Approach*, (Oxford: Oxford University Press, 2009). See also JA McCahery and EPM Vermeulen, *Corporate Governance of Non-Listed Companies*, (Oxford: Oxford University Press, 2008).
[52] See JM Mendoza, C Van der Elst and EPM Vermeulen, "Entrepreneurship and Innovation, The Hidden Costs of Corporate Governance in Europe", (2010) 7 South Carolina Journal of International Law & Business 1.
[53] See The Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub.L. 111-203, H.R. 4173).

before submitting remuneration proposals to the actual shareholders meeting, arguably leading to more shareholder engagement.[54]

Unfortunately shareholder engagement alone does not necessarily stimulate long-term thinking within a corporation. In this context, the European discussion makes clear that involvement of institutional investors is mainly limited to voting their shares in line with the information provided by proxy advisors, giving the proxy advisory industry a crucial role in the corporate governance process in listed companies.[55] Arguably, corporate executives, aware of the importance of the advisors' recommendations, pro-actively change their strategies in order to receive proxy advisors' support. If these voting recommendations are mainly based on corporate governance checklists without taking long-term growth perspectives of companies into account, the proxy advisory industry will only add to the short-term mentality of corporate managers, boards and shareholders.[56] This explains the European Commission's broader focus on the role of proxy advisors and the transparency of their actions, but also the composition, functioning and evaluation of the board of directors and the long-term engagement of shareholders.[57]

2. The Latest Academic Discussion: The Two-Dimensional Focus on Long-Term Investors

Academic thinking seems to support the broader focus of the corporate governance reforms. They increasingly point at the regulatory misconceptions in the traditional corporate governance debate.[58] The emphasis has been too much on reducing principal-agent problems between managers and shareholders. A focus solely on these problems has led to overregulation, making listed corporations bureaucratic and short-term oriented.[59] In response, one strategy has been to redirect the corporate governance debate to the dilemma of shareholders involvement. The great challenge for today's policymakers is to adequately deal with the separation of 'ownership from ownership' or the

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[54] See JF Cotter, AR Palmiter and RS Thomas, "The First Year of 'Say on Pay' under Dodd-Frank: An Empirical Analysis and Look Forward", Working Paper, 17 February 2013. See also M Shah, "Executive Pay Votes May Be Harming Shareholders", The New York Times DealBook, 26 February 2013.

[55] See European Commission, Green Paper, The EU Corporate Governance Framework, COM(2010) 164 final, Brussels, 5.4.2011.

[56] See European Securities and Markets Authority (ESMA), Discussion Paper, An Overview of the Proxy Advisory Industry. Considerations on Possible Policy Options, ESMA/2012/212, 22 March 2012. This short-term mentality will even be stronger if non-compliance with checklist provisions is followed by lawsuits. Consider the filing of a series of class actions demanding more information about remuneration policies and decisions. See "The Say-On-Pay" Payday, The Economist, 16 February 2013.

[57] See C Van Der Elst and EPM Vermeulen, "Corporate Governance 2.0: Assessing the Corporate Governance Green Paper of the European Commission", (2011) 8 European Company Law.

[58] See J Loyd, "Human Capital", Financial Times, 22 February 2013; LE Strine, Jr., "Ordinary Investors Of The U.S. And EU Unite: A Reflection On The Common Interest Of Americans And Europeans In A Corporate Government System Focused On Sound, Sustainable Wealth Creation", Lecture at Tilburg University, 18 March 2013; J Armour and JN Gordon, Systemic Harms and the Limits of Shareholder Value, Lecture at LSE Corporate Law and Finance Roundtable, 28 February 2013.

[59] See EPM Vermeulen, "Entrepreneurship and Innovation in Listed Companies: What is the Role of Corporate Governance?" In OECD (2012), *Corporate Governance, Value Creation and Growth, The Bridge between Finance and Enterprise*, (Corporate Governance, OECD Publishing, 2012).

'horizontal agency problem'.[60] How can the interests of short-term investors be aligned with the interests of long-term investors? Several creative and provocative solutions are offered in the literature. For instance, a flexible trading tax, imposing a higher tax on gains realized on the sale and transfer of shares that were held for a shorter time period, could encourage long-term shareholdings.[61]

In recent years, some scholars have suggested a more radical back-to-basics approach to the nature of the corporation.[62] This view assumes that the corporation having become too much of a control device mainly focused on solving principal agent problems. Together these ideas suggest that there is more to a corporation than increasing shareholder or stakeholder value. Another way to describe the corporation is as an incentive system in which a number of legal and non-legal mechanisms, such as trust and reputation, interrelate so as to deal with problems of commitment, motivation and coordination inside the firm.[63] This approach suggests that policymakers around the world should re-examine their corporate governance priorities and figure out ways to re-establish the corporation's original incentive structure. One way to build 'trust' and long-termism into the behavior of listed corporations and their participants is the introduction of the 'trust firm'.[64] The main characteristics of the trust firm are a board of trustees whose main function is to uphold a credible and consistent set of corporate values. In sum, corporate values should take the long-term interests of all the stakeholders (employees, customers and shareholders) in the firm into account. Conceivably, the long-term mentality could be guaranteed by linking voting rights to the time the shares are intended to be held in the future. Investors' prospective investments commitment and the attached voting rights would appear in the shareholders' register. Not unreasonably, the allocation of voting rights would be denied to unregistered, short-term, shareholders.

3. A More Effective and 'Practical' Solution: A Three-Dimensional Model of Corporate Governance

a) The Incompleteness of the Current Corporate Governance Discussion

The well-known corporate governance initiatives discussed above in Sections 2.1 and 2.2, focus on ways to shift the investment focus of investors and methods of incentivizing long-term investors. We are generally supportive of these initiatives but note they have several drawbacks.[65] To begin, they are hard and time-consuming to implement. Nevertheless, there are bigger issues to address in the

[60] See also EPM Vermeulen, "Beneficial Ownership and Control: A Comparative Study - Disclosure, Information and Enforcement", (2013) OECD Corporate Governance Working Papers No. 7.
[61] See LE Strine, Jr., supra n 58.
[62] See for instance, C Mayer, supra n 24.
[63] See EPM Vermeulen, *The Evolution of Legal Business Forms in Europe and the United States, Venture Capital Joint Venture and Partnership Structures*, (The Hague: Kluwer Law International, 2003)
[64] See C Mayer supra n 24.
[65] See, for instance, IM Millstein, supra n 24.

context of the current corporate governance discussions. First, many commentators work from the erroneous assumption that short-term investors in the stock market are to blame for the short-term mentality within listed companies. Second, the initiatives presuppose that major (mostly regulatory) improvements to the corporate governance framework are necessary to build long-termism into corporations. Third, in order to realize the long-termism aspiration, it is not only required that corporations become responsible and engage long-term actors in the corporate governance arena, but that initiatives also formally target the shareholders and their advisors.[66] Fourth, although it is widely acknowledged that a corporate governance framework cannot be captured in a one-size-fits-all model, the recommendations are often general and focused on (monitoring) formalities.

Fifth, the implementation of the initiatives may even have a destructive effect on the growth perspectives of listed firms. This is clearly reflected in the increasing number of newspaper articles and blog entries discussing the failing role of boards in supporting companies' growth and innovation capabilities. It is widely acknowledged that boards have an important responsibility in the area of risk oversight, compliance and the setting of remuneration packages. But, corporate governance frameworks generally also envision a role in improving corporate performance by approving strategy directions and giving 'informal' advice and support to the executive managers.[67] In practice, however, this latter role receives less and less attention. As this example suggests, the one-dimensional and two-dimensional corporate governance discussions have framed corporate boards as nothing more than excessively formal control mechanisms on executive managers, particularly the CEO.[68] For instance, most emphasis is put on procedures that ensure independence and long-termism, such as board composition requirements, age requirements, maximum term requirements, gender diversity, and splitting the roles of chairman and CEO.[69] Ironically, recent studies seem to indicate that the excessively formal one-size-fits-all approach to the duties and tasks as well as the composition of the board of directors has turned, particularly non-executive, directors into 'toothless', unproductive and irrelevant watchdogs who are sometimes destructive to business growth.[70] The fear of inadvertently 'shirking' the risk oversight responsibilities (which could result in reputational damage and imprisonment) has resulted in a short-term, check-the-box, mentality. So far, the emphasis in the boardroom has increasingly appeared to become one of form over substance. In other words, the

[66] See P Montagnon, "Investors Must Look at More Than Pay Scales", The Financial Times, 26 March 2013.
[67] See R Adams, BE Hermalin and MS Weisbach, "The Role of Boards of Directors in Corporate Governance: A Conceptual Framework & Survey", Journal of Economic Literature; R Adams, "The Dual Role of Corporate Boards as Advisors and Monitors of Management: Theory and Evidence", AFA 2002 Atlanta Meetings. See also LA Bebchuk and MS Weisbach, The State of Corporate Research, (2010) 23 Review of Financial Studies 939.
[68] See D Cossin, "Corporate Boardrooms are in Need of Education", The Financial Times, 9 January 2012.
[69] See P Whitehead, "Non-Executive Director: A Task for Which No One is Qualified", The Financial Times, 10 April 2013.
[70] See D Medland, "Better Boards: Non-Executive Roles 'of Little or No Value to the Business", The Financial Times, 10 April 2013. See also O Faleye, R Hoitash and U Hoitash, "The Trouble with Too Much Board Oversight", (2013) Sloan Management Review 52.

formal responsibilities of board members has severely limited the available time needed to discuss areas that may add value to the business.[71] This is regrettable because it may severely limit and distorts the dynamics of a well-functioning board.

This brings us to the final and most important drawback of the proposed corporate governance initiatives and reforms. Ultimately, they largely ignore what really matters to the players in the corporate governance arena (such as short-term investors, long-term investors, customers and employees of a firm): value creation through growth and innovation. Indeed, the role of corporate governance, corporate culture, board dynamics and investor relations as a competitive advantage in promoting entrepreneurship, innovation and growth in listed companies is usually largely overlooked. This is worrisome, because anecdotal evidence regarding high potential growth companies (supported by the analysis of our hand-collected samples of 110 listed companies in Section 3 of this paper) seems to indicate that the most innovative and best-performing companies (which show high growth and a robust stock price performance) often deviate from the pre-defined, agency-based 'check-the-box' framework. It appears that their organizational structure seems more dedicated to developing innovative products, expanding to new markets and surprising their customers or clients with disruptive technologies and processes that stand apart from the competition.[72]

b) Including Growth and Value Creation in the Corporate Governance Discussion

So, how do the governance structure of these companies provide an illustration of what is different from what is assumed under the one-dimensional or two-dimensional corporate governance models? As we have seen, there is no straightforward answer. Not only do companies operate in different sectors, but also in different legal, fiscal, economic, social and cultural environments. Moreover, companies progress through different life cycle stages. Besides they also have different backgrounds. Evidence would merit the use of different corporate governance mechanisms. Consider the following examples. LVMH Moët Hennessy Luis Vouton S.A., the French luxury goods multinational, employs multiple voting shares. The family has 46 percent of the shares but controls 63 percent of the voting rights as per 31 December 2012. This a-typical corporate governance structure does not seem to bother the investors, and rightly so. LVMH has not only shown a continued positive stock price performance, but also offers its minority retail investors shareholders, who own approximately 4.9 percent of the outstanding shares, the opportunity to become more 'engaged' by applying for a membership to their loyalty program, the Shareholders' Club. The

[71] See P Whitehead, "Why a Boardroom is the Least Bad Option", The Financial Times, 7 March 2013.
[72] See A Vance, "Steve Balmer Reboots", BloombergBusinessweek, 12 January 2012 (stating that if Microsoft's CEO, Steve Balmer had to do it all over again, he would dedicate more time to watching over the development process of products rather than just issuing a vision to the company).

program smartly targets retail shareholders and links them to the LVMH's broad product-line.[73] French retail investors who have become a member of the Club are offered special discounts.[74] The most important feature of LVMH's governance structure, however, is Bernard Arnault, the CEO, Chairman of the Board and (together with the Arnault family) holder of 63 percent of the voting rights. The equity analysts and investors view him as a competitive advantage and the engine of LVMH's recent and future growth.[75]

Consider also US Internet company, Google. We suggest that this case provides a second example of how a company can use corporate governance as a competitive advantage in its efforts to enhance long-term growth. On 31 December 2012, the Google founders and its Executive Chairman owned approximately 92 percent of the outstanding class B shares, giving them about 65 percent of the firm's total voting power while their economic interest was only approximately 20 percent. Since their IPO in 2004, Google's founders have made very clear to investors and other stakeholders that they were not impressed by the one-dimensional corporate governance discussion.[76] In the face of clear market harzards, they stated clearly in their 2004 IPO Letter that the dual-class share structure was designed to give the founders control over the company's destiny over long time horizons.[77] This statement was reiterated in the 2012 Founders' Letter.[78] It turns out that they also decided to 'walk the talk' in 2013 by announcing a new class of non-voting shares that would be distributed to existing shareholders in a 2-for-1 stock split without diluting the founders' voting power.

Notice that investors did not complain, even though Google's 2012 stock price performance was 'only' 10 percent (just below the S&P500 Index of 13.41 percent). Against this background, what do the corporate governance experts generally think of Google's ownership structure? The one-dimensional thinkers, who tend to look at it in principal-agent extremes, criticize investors' lack of control, which is a fundamental weakness in their view. Apparently, they have issues with the issuance of non-voting stock which makes it easier for the founders to maintain perpetual control.[79] Conversely, proponents of the two-dimensional corporate governance model refer to the 2004 IPO

[73] See www.lvmh.com.
[74] See http://www.lvmh.com/investor-relations/shareholders/shareholders-club
[75] See Bloomberg, "As LVMH Sales Growth Slows, Will Bernard Arnault Go on a Buying Spree?", The Business of Fashion, 22 February 2013. See also D Jolly, "Hermès Profit Rises, and Not Just in Asia", 21 March 2013.
[76] See http://investor.google.com/corporate/2004/ipo-founders-letter.html
[77] Similarly, Amazon.com wrote in its first shareholder letter in 1997 that 'it is all about the long term' and 'offering our customers compelling value'. Its corporate governance statement still states that Amazon continues to (1) focus relentlessly on its customers, (2) make bold investment decisions in light of long-term leadership considerations rather than short-term profitability considerations, (3) focus on cash, (4) work hard to spend wisely and maintain its lean culture, and (5) focus on hiring and retaining versatile and talented employees, and weight their compensation to significant stock ownership rather than cash. See http://phx.corporate-ir.net/phoenix.zhtml?c=97664&p=irol-govHighlights
[78] See http://investor.google.com/corporate/2012/founders-letter.html
[79] See B Womack, New Google Stock Structure Preserves Founders' Control at Investors' Expense, Bloomberg News, 12 April 2013.

Letter and argue that the dual-class structure makes it easier, in the transition to public ownership, to follow a long-term strategy, unaffected by the short-termism in the stock market.[80]

We have argued above for a three-dimensional corporate governance model which also makes the case for the acceptability of the a-typical organizational structures. Compared with the two-dimensional model, however, it provides a more practical explanation for the benefits of a dual-class structure for Google. From the perspective of investors and equity analysts, who make buy/sell recommendations, the Google example shows that they are mostly concerned about the potential for future firm growth. Moreover, while there is a concern for the governance framework, they do not seem to care too much about it as long as it incentivizes the parties involved, particularly the founders, controlling shareholders or executive managers, to continue grow the business (or, as written in Google's 2012 Founders' Letter, 'to create technology products that enrich millions of people's lives in deep and meaningful ways').[81] There is empirical support for the positive investor sentiment regarding Google in the data collected by data provider FactSet.[82] More specifically, they found that 32 of the top 50 world's largest hedge funds held long positions in Google at the end of Q4 2012.[83] Still, we can expect that the corporate governance discussion will resurface when the companies settle for a no-growth or slow-growth scenario without clearly communicated plans to turn things around. In some quarters, Apple supplies a good example of this trend.

There are many things to say about Apple's governance structure. We could, of course, talk about Steve Jobs, who co-founded the company on 1 April 1976, left Apple in 1985 after a power struggle within the company, and returned to Apple in 1997 after it acquired NeXT (a computer/software company founded by Steve Jobs).[84] Moreover, we could, for instance, discuss the fact that Steve Jobs was not ready to make a long-term commitment to Apple in the first three years after his return. He only accepted to become an interim-CEO with a fixed salary of $1 per year. It was only until 2000 that he changed his title to 'iCEO', received an airplane and bargained for a stock options arrangement. We could of course look into the stock options further and discuss how the burst of the Internet bubble in 2000 (and the subsequent drop in the stock price) started the conversation about renegotiating the stock option grant in 2001.[85]

[80] See C Mayer, n 24.
[81] We find similar language in LVMH's letter to shareholders of March 2013: 'Our business – excellent products – is experiencing a growing influence from new customers expressing a desire for authenticity, aspiring towards custom-made items or services and increasingly aware of what makes our products special: their creative appeal and finely crafted quality. This deeply rooted trend will open up a panoply of exciting prospects for us'.
[82] See M Amenta, FactSet Hedge Fund Ownership, Q4 2012: Apple Continues to Fall Out of Favor, 21 February 2013.
[83] See M Gongloff, "Hedge Funds Love Apple Stock Less And Less These Days", The Huffington Post, 21 February 2013.
[84] See JD O'Grady, *Apple Inc.*, (Westport: Greenwood Press, 2009)
[85] See T Worstall, "Steve Jobs Obituary: The Backdated Options Scandal", Forbes, 6 October 2011.

However, here the focus is on the board of directors which played a crucial, but increasingly obedient role in Apple's history. Recall, that it was the board that removed Steve Jobs as Head of the Macintosh division in 1985. Following his return in 1997, Steve Jobs, who initially started in an advisory role (next to being the CEO and Chairman of a computer animation company, called Pixar), quickly regained more control over the company's affairs.[86] This became clear in the keynote address during the Macworld Expo in Boston on 6 August 1997,[87] where he explicitly did not announce new and innovative products, but the appointment of four new, handpicked, board members.[88] To gain a better understanding of the role of the board, Jobs was convinced that changing the composition of the board of directors was a necessary first step to bring back focus, relevance and interaction (with the outside world) to the company in its journey to introduce disruptive innovations and creative products to its potential customers.[89] What is most interesting in light of this paper is that Steve Jobs knew that in order for the board of directors to become a competitive advantage and help carry Apple forward, its members needed to have a thorough understanding of the computer industry and be passionate Apple users. This is the reason why Mr. Woolard, Chairman and former CEO of Dupont, and Mr. Chang, a senior executive at Hughes Electronics, were 'allowed' to stay for their leadership skills and knowledge of the Asian market respectively. Mr. Ellison (software expertise and co-founder of Oracle), Mr. York (Former CFO with experience with reorganizations at both Chrysler and IBM), Mr. Campbell (CEO of Intuit and former Vice President of Sales and Marketing at Apple) were also added to the Board of Directors. Unsurprisingly, Steve Jobs was also asked to join the Board of Directors.

The discussion above indicates that Steve Jobs designed, modeled and molded the board of directors to Apple's growth and innovation needs, but also his personal tastes.[90] The latter has of course spurred the debate among conventional corporate governance experts about the quality and performance of the Apple board (particularly, after the corporate failures and corporate governance reforms of 2001-2002). From a traditional governance standpoint, it is difficult to understand that Steve Jobs valued industry expertise, passion and loyalty more than independence and appropriate risk-oversight qualities. Nevertheless, this became again clear when Mr. Al Gore Jr. joined the Apple Board in 2003. Steve Jobs was excited about his election: "Al [Gore] brings an incredible wealth of knowledge and wisdom to Apple from having helped run the largest organization in the world – the United States government – as a Congressman, Senator and our 45th Vice President. Al [Gore] is also an avid Mac user and does his own video editing in Final Cut Pro". Understandably, corporate governance experts, when assessing the nomination, were critical, but effectively ignored the fact

86 See D Kawamoto, "Jobs Rejects Apple Chairman Post", CNET News, 31 July 1997.
87 See J Davis, "Jobs To Keynote Macworld Expo", 29 July 1997.
88 See M Costello, "Apple Gets New Corps", CNNMoney, 6 August 1997.
89 See http://www.youtube.com/watch?v=PEHNrqPkefI
90 See W Isaacson, *Steve Jobs*, (New York: Simon & Schuster, 2011).

that Al Gore was instrumental in launching public/private partnership efforts to bring technology to educational institutions in the United States.[91] The rationales provided against his being appointed on the board of directors are all excellent indications of a different type of governance model. First, they argued that a politician without any business experience would add no value to the company. Second, they were of the opinion that Apple's board held too many 'friends of Steve'. That is, board members were (too) loyal to Steve Jobs, which allegedly undermined Jobs' accountability to the investors and other stakeholders.

However, not surprisingly from the three-dimensional corporate governance perspective, the investors, the employees and the customers continued to show confidence in Steve Jobs and 'his' board of directors. Consider the stock price performance of the company during the relevant period. Between 6 August 1997 (the day of the keynote address in Boston) and 23 August 2011 (the last day of Steve Jobs as the CEO of Apple), the stock price soared from $25.25 to $360,30, increasing 1,327 percent. So what would happen after the announcement of Steve Jobs' resignation as CEO of Apple on 24 August 2011? It was only to be expected that the stock price would fall, particularly after the 'driving force' behind the company passed away on 5 October 2011.[92] Somewhat surprisingly, the opposite occurred. On 20 August 2012, Apple became the most valuable company in the history of the United States with a market capitalization of $623.52 billion.[93] The company reached its highest stock price ever of $705,06 intraday trading on 21 September 2012. This success could largely be attributed to investors' future growth expectations for Apple. The iPhone 5 with a bigger screen was just released, a smaller iPad was announced, and perhaps most importantly, a disruptive new product that would reinvent the television, as we currently know it, was supposedly in the pipeline.

Notice, however, the rationale of investing in a fast growing company suddenly disappeared after Apple's disappointing upgrade due to problems involving the operating system for iPhones and iPads. Customer complaints about the integrated mobile map software, which was inaccurate and omitted towns, buildings and roads, were followed by an official apology from Steve Jobs' successor Tim Cook.[94] Initially, the decline in the share price was slow, but it rapidly accelerated. On 31 December 2012, Apple shares traded for $532.17 per share, down $172.89 from the 21 September high, despite the fact that Apple's current CEO has continued to bring new products to the market, which produced robust and strong quarterly results.[95] Pessimistic investor sentiment caused by doubts

[91] See D Sellers, "BusinessWeek: Gore Appointment to Apple Board A Mistake", PCWorld, 27 March 2003.
[92] See ES Browning, S Russolillio and JE Vascellaro, "Apple Now Biggest-Ever U.S. Company", The Wall Street Journal, 20 August 2012. See also
[93] See C Mikolajczak, "Wall Street Flat After Rally; Apple Biggest Company Ever", Reuters, 20 August 2012.
[94] See C Smith, "Tim Cook Issues Apology For Apple Maps", The Huffington Post, 28 September 2012. See also http://www.apple.com/letter-from-tim-cook-on-maps/
[95] See H Tsukayama, "Apple's Cook Says Firm In 'Prolific' Period Of Innovation", The Washington Post, 24 January 2013.

about the company's future growth rate explains Apple's negative stock price performance during the second half of 2012.

What is interesting from a corporate governance point of view is that these doubts were to a large extent triggered by 'failures' in Apple's communications and investor relations' strategy. First, there was a lack of communication with equity research analysts and investors, resulting in missing analysts' targets and consequently negative media attention and a depressed stock price.[96] Second, on the rare occasions of Apple interacting with the market, the communication was flawed and disappointing, signaling there was a potential growth issue.[97] For instance, in October 2012, Apple's CEO said that this was the 'most prolific product period in Apple's history'.[98] He was referring to the 'innovations' to existing products, which the market viewed as evolutionary rather than revolutionary.[99] Of course, improvements to Apple's products did bring growth, but did not spur the rapid and long-term growth that analysts needed to justify Apple's high stock price (particularly, since the competition (read: Korea's Samsung) was dominating fast growing markets, such as China and India,[100] and was on its way to quickly catch up in other markets).[101] Finally, instead of announcing game-changing breakthroughs in new products or markets, Apple endeavored to boost the stock price with the introduction of high dividends and stock buybacks.[102] As mentioned above, these short-term strategies should be used sparingly in order to avoid winding up in the vicious circle of one-dimensional corporate governance discussions, which would not only lead to deteriorating investors' confidence, but also declining employee trust in the company.[103] This is particularly true for Apple that continued to fall out of favor of the hedge funds community.[104] For example, during Q4 2012, hedge funds made significant reductions to their long holdings in Apple while at the same time they increased their exposure to equity.[105]

Our analysis of the Apple-case helps highlight the differences between the one-dimensional (and two-dimensional) model on the one hand and the three-dimensional model on the other hand. In the traditional view, boards of directors are designed to perform an oversight function independently of

[96] See J Yarow, "The 10 Biggest Mistakes Of Tim Cook's Tenure As Apple CEO", Business Insider, 27 March 2013.
[97] See J Gilbert, "The Last 6 Times Tim Cook Has Talked, Apple's Stock Has Dropped", The Huffington Post, 28 February 2013.
[98] See http://www.apple.com/pr/library/2012/10/29Apple-Announces-Changes-to-Increase-Collaboration-Across-Hardware-Software-Services.html
[99] See B McLean, "Should Apple be a $200 Stock?", Reuters, 6 February 2013.
[100] Here it is interesting to mention that Apple's board member (Mr. Chang) with experience in entering emerging markets left the board of directors in 2001.
[101] See B Viswanathan, "Why Is Apple Stock Falling Down?", Forbes, 12 February 2013. Investors in Hewlett-Packard have a similar view. See A Vance and A Ricadela, "Mark Hurd, Leo Apotheker, Meg Whitman in Hewlett-Packard's Vertigo", BloombergBusinessweek, 14 January 2013 (citing an analyst: "Mark Hurd was cutting costs and doing a good job of it, but you can't cut costs forever, and investors wanted to see growth").
[102] See JE Lessin, T Demos and D Benoit, "Apple Cash Pile Sets Off a Battle", 8 February 2013.
[103] See J Pepitone, "Apple Employees Downgrade Tim Cook", CNNMoney, 15 March 2013.
[104] See M Verma, "Google Inc. (GOOG): Hedge Funds and Insiders Are Bearish", Insider Monkey, 12 March 2013.
[105] See M Amenta, supra n 82.

the CEO and other executive managers.[106] In speaking of the three-dimensional model, which focuses in the first place on growth and value creation, the board of directors serves as an extension of management, providing outside expertise and experience where and when needed without ignoring its oversight responsibilities. It is essential that boards are entrepreneurial, challenge management decisions, identify opportunities and network with governments, society and other stakeholders.[107] Given these considerations, it is clear that we need to change our understanding about the selection of board members.[108] In order to have well-balanced boards, it is important to go beyond the usual selection criteria, such as independence, integrity, competence, reliability, good judgment and preferably a financial background. Boards also need outside directors who are product and market-oriented and able to ask the right, often technical, questions.[109] Arguably, a well-balanced board with a mix of compliance and growth/innovation-focused members was essential in making Apple the successful, growing company that has generated significant returns for its investors and other stakeholders.[110]

It also follows from the Apple-case that there is no one-size-fits-all blueprint in the three-dimensional model. And there is another important observation. Corporate governance is dynamic/fluid in nature.[111] More specifically, the unique governance issues that result from including growth in the corporate governance discussion are part of a complex, three-dimensional continuum, wherein each of the dimensions (managerial control, long-term commitments and growth) are intertwined and constantly evolving. This became very clear from Apple's failing interaction with the market. Steve Jobs was famous for his powerful and charismatic keynote presentations that contributed largely to the stock market's growth expectations.[112] Because Tim Cook is not likely the same marketing genius as his predecessor, Apple may need to alter its investor relations' strategies. Moreover, since corporate governance is about being able to quickly adapt to changing circumstances, [113] it is likely

[106] See, for instance, Kraakman et al, supra n 51.

[107] See D Cossin, supra n 68.

[108] See WG Bowen, *The Board Book, An Insider's Guide for Directors and Trustees*, (New York: W.W. Norton & Company, 2011).

[109] Experienced board members agree with this view. See D Medland, "Non-Executives Must 'Delve Into All Areas'", The Financial Times, 7 March 2013. See also Y De Jong and J Woudt, "Kees Storm", Financieele Dagblad, 13 April 2013. Interestingly, board members also prefer one-tier board systems. At this point we do not take a strong position on this debate, but make the following argument. One-tier boards are arguably better equipped to facilitate the 'supervision (ensuring the company's strategy is right and well implemented) to co-creation (overcoming blind spots) to supporting the executives (within the company and with outside stakeholders)'. See Cossin, supra n 68.

[110] Arguably, the board of directors also contributed significantly to making Steve Jobs the best performing CEO in the world in terms of creating market capitalization. See M Hansen, H Ibarra and U Peyer, "100 The Best-Performings CEOs in the World", Harvard Business review, January-February 2013.

[111] See also P Zumbansen, "Rethinking the Nature of the Firm: The Corporation as a Governance Object", (2012) 35 Seatlle University Law Review 1469.

[112] See also T Chemmanur and A Yan, supra n 38.

[113] See J Yarow, "The Only Thing That Has Really Changed at Apple is that There's No More Reality Distortion Field", Business Insider, 12 March 2013.

that the composition of the board of directors can be more effectively rebalanced to supplement its current resources.

Alternatively, if a company has a need to expand to emerging markets, it might need international experience on the board.[114] But if it has already board members with a wealth of international know how and need more technical risk-management and accounting skills, then that is what it should look for. Another example is a venture capital backed company that is planning an IPO. There is usually not a lack of growth-oriented spirit on the boards of these companies. The relatively high number of venture capitalists on their boards can partly explain this. Clearly, the lockup periods, which prevent venture capitalists to exit the company upon or immediately after the IPO, explains their board positions. Following the three-dimensional continuum, it could be advisable to add more independent financial sophistication to the board of such companies.[115] As noted above, beyond the IPO, however, companies usually start losing their entrepreneurial spirit. They may become less responsive to disruptive innovations and see talented employees leave for hotter start-up companies.[116] In this context, the recruitment of venture capitalists on the board could provide a solution.[117] As such, they could assist a mature company's executive management with initiating open innovation strategies through which the company partner with smaller companies.[118] Applying this logic, these open innovation strategies are increasingly viewed as a successful 'healthy aging' model in the life cycle of listed companies.[119] The dynamics of the three-dimensional corporate governance model are reflected in Figure 1.

In this section, we have argued that the three-dimensional corporate governance model provides a better understanding of the dynamics in the practice of corporate governance. It may also have another advantage over the traditional models. In the one-dimensional model, the responsibility for upholding corporate governance standards is shifted to policymakers and regulators. More and more

[114] See JH Daum and JC Norris, "Adding International Expertise: Opening The Board's Window On The World", SpencerStuart, 2007. To give one example, Japan's two largest mobile games companies, GREE and DeNa, have shown a constant growth in the social gaming world in Japan. Following the three-dimensional model of corporate governance, both companies have a balanced board composition with several members with industry expertise. Both companies have global expansion plans, but fail to generate revenues outside Japan (which had a negative effect on the stock price performance). Adding international experience to the board could be considered as a necessary first step in their execution of their global expansion plans. See S Dredge, "Mobile Social Game Giants GREE and DeNa Report Sharp Financial Growth", The Guardian, 9 May 2012.

[115] The accounting issues that Groupon experienced in their post-IPO era great examples of this. See D Aubin, "Analysis: Groupon Accounting Problems Put Spotlight On Board", Reuters, 12 April 2012. This also explains the renewed discussion about Apple's board of directors when director York passed away in 2010. He was viewed as an independent director who had to be replaced in order to maintain a balanced board. See YI Kane and JS Lublin, "On Apple's Board, Fewer Independent Voices", The Wall Street Journal, 24 March 2010.

[116] See C Cain Miller, "Trying to Recapture Start-Up's Feel, Google's Chief Fights Hard Against What He Sees As Its Worst Enemy: Itself", Harold Tribune, 10 November 2011.

[117] See WG Bowen, supra n 108.

[118] See U Celikyurt, M Sevilir and A Shivdasani, "Venture Capitalists in Mature Public Companies", UNC Kenan-Flagler Research Paper No. 2013-4, 5 May 2012.

[119] See S Murray, "Corporate R&D: Big Groups Struggle to Bring Ideas to Fruition", The Financial Times, 28 October 2011.

regulatory interventions are needed to resolve the principal-agent problems between the companies, its insiders and stakeholders. Although it is acknowledged that the rules and regulations that were introduced in the wake of the scandals at the beginning of the 21st century have created minimum standards and guidelines of corporate governance that actually improved the functioning of listed companies, it is far from clear whether more stringent and detailed rules for the companies would have a similar effect. This is illustrated in the two-dimensional model. Proponents argue that in order to build long-termism into the corporation, it is essential to change the behavior of the investors. We have discussed several suggestions in Section 2.2. The three-dimensional model's focus on growth and value creation posits that the companies (and their executive managers and executive and non-executive directors) are responsible for implementing a well-functioning governance structure. Our view indicates that regulators and institutional investors are likely to play a very limited governance role. In this respect, the three-dimensional model is easier to understand and more straightforward to implement. The question arises concerning which elements or mechanisms could be considered by the companies in order to create a competitive advantage in one of the existing or future markets. The next Section will try to answer this question by analyzing how the three-dimensional corporate governance model works in practice.

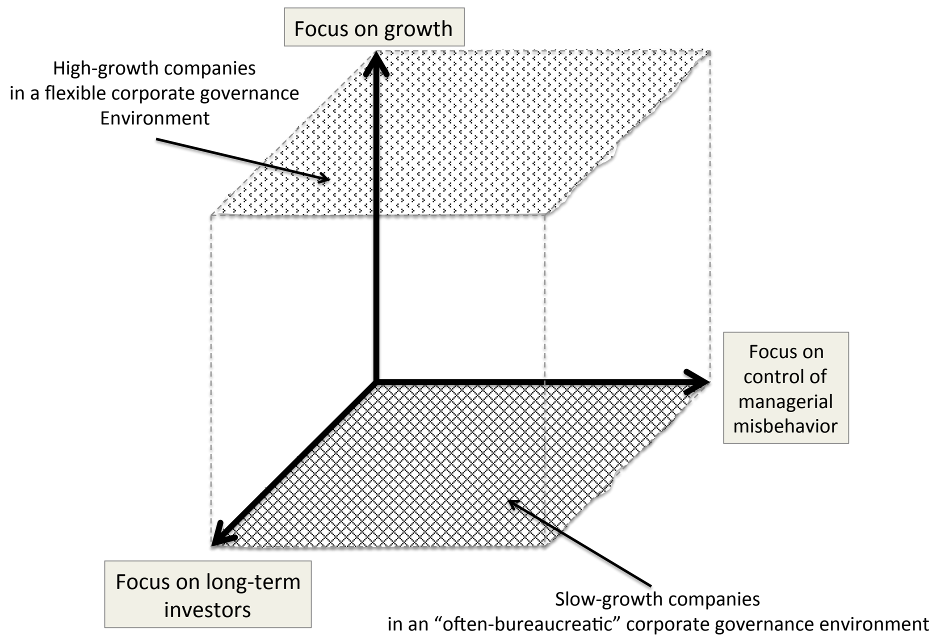

Figure 1: The Three-Dimensional Model of Corporate Governance

III. The Practice of Three-Dimensional Model of Corporate Governance

We can take two hypothetical lessons from Section 2. The first is that there is more to corporate governance than reducing principal-agent problems (in order to maximize shareholder value) and trying to attract long-term and committed shareholders. Thus, a focus solely on these issues tends to make the business organizations bureaucratic and short-term oriented, which in turn may crowd out entrepreneurship in listed companies. Bureaucracy distracts executive managers and members of the board of directors from their essential duty and responsibilities to grow the business and create business value. It is time to acknowledge that corporate governance has three connected dimensions (managerial control, long-term commitments and growth). While little empirical research has examined the relationship of these dimensions, it appears that changes in one dimension will usually affect the other two dimensions. Most important in this respect is that there are positive side effects that come with an increased focus on growth and value creation. For example, in this Section we will see that a growth-oriented governance structure that offers competitive advantages not only reduces investors' demand for managerial control mechanisms, but also tends to build long-termism into the organization.

The second hypothetical lesson is that companies, particularly their executive managers and members of the board of directors, are in the driver's seat when it comes to implementing effective corporate governance structures focused on rapid and long-term growth, commitment and firm value. Overall, we argue that it is time for corporate governance experts to understand their role in relation to a firm's product and market innovation potential. Yet in many companies, corporate governance is disenfranchised from the growth and innovation process and relegated to the role of managerial control and accountability. What kind of measures could or should be implemented? Are there any best practices to align a company's governance structure with its growth aspirations? In order to answer these questions, we analyze 110 listed companies that have either more than average growth potential or show a more than average interest in product and market innovation. To be sure, the data shows that corporate governance arrangements that contribute to value creation processes are difficult to capture in a one-size-fits-all and pre-defined rulebook. This paper does not claim that it can explain all the variance in corporate governance in firms, rather it investigates the influence of the third dimension in shaping firms' activities. That said, there are some general points of good practice, which could provide companies with a competitive advantage.

In this section, we will proceed as follows. First, we will describe the data. Second, we will show that shareholder value and other stakeholders' satisfaction should mainly be attributed to a firm's growth and innovation potential (instead of managerial control mechanisms and investor commitment).

Third, we will discuss two critical, but largely ignored topics in corporate governance research: (1) board dynamics and composition, and (2) investor relations. Rather than rely on data solely, we will again use the Facebook case study as a starting point to assess and explain whether and to what extent these topics will shape the future of corporate governance and stimulate further discussion. Finally, the results from our analysis of the data are used as illustration to support our findings in terms of the effects of the three-dimensional corporate governance model.

1. The data

In this sub-section, we briefly describe our sample selection and provide a couple of notes on the used methodology. This paper uses two hand-collected data sets to study 'best-practices' in growth-oriented listed companies. The first data set is summarized in Table 1 and consists of 70 venture-capital backed companies that conducted an IPO on US stock exchange in 2011 and the first half of 2012 (VC-70). The 2011 companies are derived from the complete database directory of DowJones VentureSource related to IPOs. The 2012 list contains the complete set of companies that floated their shares according to database provider Preqin. The corporate governance characteristics, particularly the information regarding the composition of the board of directors, the experience and expertise of members of the board of directors at the time of their appointment, the peculiarities of the shareholders and the investor relations activities are mainly collected by analyzing companies' websites. Data regarding IPO performances, trading volumes and short-selling activities is mainly gathered from Nasdaq's market activity website, ft.com/marketsdata, Morningstar, Reuters and The Wall Street Journal. We use the same sources to gather similar information for our second hand-collected database, which consists of the top-40 companies that appeared in the FT Global 500 2012 list (FT-40). In order to make the comparison with the 'young' listed companies more relevant, we exclude companies that operate in the oil and gas industry and financial industry. Table 2 lists the 40 companies. In order to avoid selection bias in our study, we included and analyzed the complete set of the companies.

Why are we interested in comparing the corporate governance structure of the VC-70 and the FT-40 companies? Admittedly, we expected to see enormous differences in the governance structures of the two types of companies. Compared to the FT-40 companies that have operated for a long time in the bureaucratic and overregulated arena of the stock market, the companies that recently floated their shares still have ample opportunity to deviate from the 'one-size-fits-all' corporate governance rulebook.[120] For instance, as mentioned in Section 2, lockup provisions may explain differences in the

[120] See Fenwick&West LLP, Corporate Governance Practices and Trends, A Comparison of Large Public Companies and Silicon Valley Companies, 2011; Wilson, Sonsini, Goodrich & Rosati Professional Corporation, Corporate Governance and

investor base of the companies. Moreover, the VC-70 companies arguably give more importance to growth and innovation, which could explain other differences in corporate practices. The variations in corporate governance organizations would then be an explanation for the FT-40 becoming less responsive to disruptive technologies.[121]

Table 1: Venture Capital Backed IPO Companies in 2011 and 1H 2012 (VC-70 Companies)

Companies		
AcelRx Pharmaceuticals	Gevo	Skullcandy
Angie's List	Groupon	Solazyme
Audience	HomeAway	Splunk
Bazaarvoice	Horizon Pharma	Supernus Pharmaceuticals
BG Medicine	Imperva	Synacor
Boingo	Infoblox	Tangoe
Brightcove	Intermolecular	Tesaro
CafePress	InterXion Holding	The Active Network
Carbonite	Invensense	Tranzyme
Cempra Pharmaceuticals	Jive Software	Ubiquiti Networks
Ceres	KiOR Inc	Vanguard Health Systems
Chemocentryx	LinkedIn	Verastem
Clovis Oncology	Merrimack Pharma	Vocera
Cornerstone OnDemand	Millennial Media	WageWorks
Demand Media	Neophotonics	Yandex
Demandware	Pacira Pharmaceuticals	Yelp
Ellie Mea	Pandora Media	ZELTIQ Aesthetics
Endocyte	Proofpoint	Zillow
Enphase Energy	Proto Labs	Zipcar
Epocrates	Renewable Energy Group	Zynga
Exa	Responsys	
ExactTarget	RPX Corp	
Facebook	Sagent Pharmaceuticals	
Fluidigm	ServiceNow	
Fusion-io	ServiceSource International	

Interestingly, however, we find that the VC-70 and FT-40 companies have more similarities than initially meets the eye. They have two important things in common. First, both the VC-70 and the FT-40 companies can be considered important 'job creators'. At the end of 2012, the VC-70 companies employed 90,482 persons. The FT-40 companies have created 599,671 new jobs between 2009 and 2012. Second, both the VC-70 and the FT-40 companies are growth-oriented firms. Firms in such a context have either aspirations to become world leaders in specific technologies (the venture capital backed companies) or are already considered to be world-class companies (the Top-40 of the FT Global 500). Both the VC-70 and FT-40 companies have a strong strategic focus on innovation. This is obvious for the VC-70 companies that are still venture capital backed. But also the FT-40 companies

Disclosure Practices of Venture-Capital Backed Companies in U.S. Initial Public Offerings, January 2010 through June 2011, 2011.

[121] See P Burrows, "CEO, the Least Popular Job in Silicon Valley", BloombergBusinessweek, 28 September 2011.

seem driven by innovation. This is evidenced by the fact that 80 percent are considered to belong to the list of most influential units in the area of corporate venturing and corporate venture capital (see also Table 2).[122] In order to accelerate the innovation cycle or to expand their technological positions to emerging markets, they have established funds to either make direct investments in high-growth start-up companies or acquire limited partnership positions in separately managed venture capital funds.[123] The corporate venturing strategies provide the companies with a window to the market and help them to find the 'next big thing'.[124]

Table 2: Top 40 of FT500 2012 Companies (excluding oil and gas producers and financial institutions)

Companies		
Abbott Laboratories	IBM* (16)	Roche***** (6)
Amazon.com****** (9)	Intel* (1)	Samsung Electronics* (9)
Ambev	Johnson & Johnson ***** (2)	Sanofi***** (29)
Anheuser-Busch Inbev	LVMH****** (5)	SAP* (6)
Apple	McDonald's	Siemens**** (2)
AT&T******* (25)	Merck***** (52)	Toyota Motor** (14)
Basf**** (4)	Microsoft* (15)	Unilever****** (1)
British American Tobacco	Nestle****** (3)	Verizon Communications******* (12)
China Mobile	Novartis***** (1)	Vodafone Group******* (7)
Cisco Systems* (5)	Oracle* (75)	Wal-Mart Stores****** (23)
Coca-Cola****** (15)	PepsiCo****** (24)	
Comcast*** (4)	Pfizer***** (7)	
General Electric**** (1)	Philip Morris International	
GlaxoSmithKline***** (5)	Procter & Gamble****** (2)	
Google* (2)	Qualcomm* (4)	

*Most influential corporate venturing technology units according to data provider GlobalCorporateVenturing (ranking)
** Most influential corporate venturing transport and logistics units according to data provider GlobalCorporateVenturing (ranking)
*** Most influential corporate venturing media-focused units according to data provider GlobalCorporateVenturing (ranking)
**** Most influential corporate venturing industrial units according to data provider GlobalCorporateVenturing (ranking)
***** Most influential corporate venturing healthcare units according to data provider GlobalCorporateVenturing (ranking)
****** Most influential corporate venturing consumer sector units according to data provider GlobalCorporateVenturing (ranking)
******* Most influential corporate venturing utilities units according to data provider GlobalCorporateVenturing (ranking)

[122] See www.globalcorporateventuring.com
[123] See JA McCahery and EPM Vermeulen, "Venture Capital Beyond the Financial Crisis, How Corporate Venturing Boosts New Entrepreneurial Clusters (and Assists Governments in Their Innovation Efforts)", (2010) 5 Capital Markets Law Journal 452.
[124] See JA McCahery and EPM Vermeulen, Conservatism and Innovation in Venture Capital Contracting, Lex Research Topics in Corporate Law & Economics 2013-2.

This brings us back to the three-dimensional model of corporate governance which, as we have argued above, points to growth as the most important factor. In this respect, it is already interesting to see if we can locate some 'best practices' that corporate governance experts should consider when making their analyses and recommendations. However, as we have seen above in the Apple-case, a mere focus on growth is insufficient. In order to be successful in attracting committed investors, talented employees and an increasing number of customers, companies should also be able to show and communicate growth to the market. This makes the analysis even more interesting. By including stock market performance (developments in share price, trading volume and short interest), we may be able to determine what really matters in corporate governance. In the next Section, we return to the Facebook-case and show that investors and other stakeholders care more about growth than one-dimensional or two-dimensional corporate governance characteristics.

2. Corporate Governance, Growth Prospects and Value Creation

An account of Facebook's disappointing IPO that uses the three-dimensional model of corporate governance reveals how retail investors were not fully informed and therefore failed to understand the operation, development and growth perspectives of Facebook.[125] Implicit in such accounts is the assumption that they ignored the early warning signs that arguably should have led to more cautious investment behavior. One of the early warning signs, which had already attracted a lot of media attention before Facebook's offering, was the general underperformance of social media/Internet IPOs. Public investors should have watched the stock in other 'hot' venture capital backed social media/internet companies, such as Pandora and Groupon, that completed an IPO in 2011 drop with an average of approximately 13 percent from the IPO price.[126] LinkedIn and Angie's List were among the few social media companies that showed a positive IPO performance after 6 months.[127]

There are several plausible explanations for the underperformance of these companies. First, the global economic challenges and the changing sentiment towards social media/internet companies are often mentioned as the main reasons for the slowdown in the IPO market.[128] Second, it is argued that social media is a hype. The companies do not really sell products. Their business models have inherent flaws and are not sustainable in the long-term. For instance, Groupon's daily deals business,

[125] See for instance T Geron, "Secondary Chances: Is There Any Life Left In Pre-IPO Shares?", Forbes, 3 October 2012; S Gustin, "Facebook IPO Fallout: Four Lessons from a Rocky Public Debut", Time, 22 May 2012.
[126] The social media/internet companies include LinkedIn, Pandora, Demand Media, Groupon, Angie's List, HomeAway and Yandex. At the time of Facebook's IPO, Zynga's 6 months performance was not available yet.
[127] The 6 months IPO performance of LinkedIn and Angie's List were 60 percent and 3 percent respectively.
[128] See R Hing, "IPO Activity Slows in Second Quarter", MarketWatch (Wall Street Journal), 27 June 2012; R Waters, "Facebook Slide Wipes Billions Off Windfall", The Financial Times, 3 August 2012; S Schaefer, "The IPO Class of 2012: facebook and Beyond", Forbes, 27 December 2011; L Spears, R David & F Hu, "IPOs Slump to Lowest Level Since Financial Crisis", Bloomberg, 28 December 2012.

initially causing excitement amongst investors,[129] has two major drawbacks:[130] (1) its easily replicable business model attracted a vast number of competitors in a relatively short period of time and (2) Groupon depends too much on its suppliers, being the merchants that use the deal giant to reach out to customers and clients. Constant supply chain and technological innovation is necessary to convince the suppliers of the benefits.[131] Facebook is different. It generates revenue and monetizes customer data by selling ads and concluding other marketing deals.[132] But here also equity research analysts and investors have doubted whether this model is sustainable. The question is indeed if the growth in revenue continues to outweigh the increasing costs of Facebook's global technology infrastructure of web-servers and datacenters.[133] More importantly, analysts have seriously questioned Facebook's potential and ability to increase revenue and profits quickly due to (1) its dependence on user growth, (2) the pressure to solve lingering privacy issues, (3) companies' willingness to pay for Facebook ads and (4) its increasing competition.[134] Yet, since these risks were also listed in Facebook's prospectus,[135] commentators argue that both institutional and retail investors should not have been surprised of the underperforming stock price.[136]

What then were the main reasons for the surge of Facebook's stock price in September 2012, November 2012 and again in January 2013? It is suggested that investors gained confidence after Mark Zuckerberg's first public interview since the IPO in September 2012.[137] During the interview he provided the long-awaited information about Facebook's strategy for mobile devices and products, an area that caused Facebook its greatest concerns. For instance, Facebook had issues monetizing on mobile products. Moreover, the functionality of Facebook on mobile devices depended largely on the operating systems and networks of third parties. Luckily, Mark Zuckerberg's vision of Facebook in the mobile market was both refreshing and convincing to investors.[138] The November surge of the stock price was also related to Facebook's potential to grow steadily and gain a significant market share in mobile social media products. The jump in investor confidence was particularly spurred by

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[129] See The Street, "Groupon: A Train Wreck in Public Sight", Forbes, 28 February 2013; R Agrawal, "Why Groupon Is Poised For Collapse", TechCrunch, 13 June 2011.
[130] See P Cohan, "Why Groupon Is Over and Facebook and Twitter Should Follow", Forbes, 20 August 2012.
[131] See DL Jacobs, "Firing CEO Andrew Mason Won't End Groupon Woes", Forbes, 1 March 2013.
[132] See G La Blanc, "Don't Count Out Facebook's Business Model Just Yet", Bloomberg, 25 June 2012.
[133] See J Leber, "The Biggest Cost of Facebook's Growth", MIT Technology Review, 16 May 2012.
[134] See J Swartz, "Facebook Must Change After IPO", USA Today, 18 May 2012; D Tam, "Analyst Warns of Facebook-ad Backlash, Sets $16 Stock Price", CNET, 8 October 2012; J Gilbert, "Risks To Facebook: The 13 Factors That Could Hurt Facebook, According To Its Amended S-1 Filing", The Huffington Post Tech, 23 April 2012. These risks are also listed in Facebook's prospectus.
[135] See Facebook's prospectus as filed with the United States Securities and Exchange Commission (SEC) on 17 May 2012.
[136] See B Bailey, "What Were They Thinking: Facebook IPO", EE Times, 25 May 2012.
[137] See B Gallagher, "Zuckerberg's Disrupt Talk Pushes Facebook Stock Up 8.9 percent To High of $21.16", TechCrunch, 12 September 2012.
[138] See J Constine, "Zuckerberg Shows He's The Right Man for the Job. Now That Job Needs Doing", TechCrunch, 11 September 2012.

its mobile advertising prospect.[139] But, there is also a more technical explanation for the increasing stock price. On 14 November 2012, it was expected that Facebook's biggest lock-up expiration – 804 million shares would become available on the market – would cause the stock price to fall again. Understandably, a number of institutional investors planned to buy Facebook stock cheaply after the expiration. However, given the improved investor confidence and IPO performance, the original investors were not eager to sell. Since the supply did not match the demand for Facebook's shares, its stock price increased more than was probably justified.[140]

It is noteworthy that Facebook's IPO performance improved after analysts indicated they were optimistic about its growth potential. That analysts play a crucial role in a company's IPO performance was again reaffirmed in January 2013. Immediately after the release of Merrill Lynch forecast indicating that conditions for Facebook's mobile business remained favorable the stock price advanced 5 percent.[141] The analysts' excitement about Facebook's strong future did not restore its stock price back to IPO levels, but at least it surpassed the $30 mark again.[142] However, analysts, mostly positive about Facebook's growth potential,[143] were not able to prevent a drop after the release of the disappointing fourth quarter 2012 results. Even though they pointed out that investors should focus on shareholder value that Facebook could create over the long term,[144] its improved stock price performance of 83 percent since early September was not sustainable. In February 2013, investors, disappointed about Facebook's revenue growth, turned their backs again to the social media company.[145] The fact that Mark Zuckerberg indicated in a Form 8-K report that was filed on 4 September 2012 that he intends to retain a significant 'skin in the game' (by promising that he will not sell shares in his company) for at least one year has not given investors sufficient comfort to change their stock selling behavior regarding Facebook.[146] Moreover, employees' belief in Facebook's leadership, growth potential and future does not seem to satisfy investors either.[147]

[139] See S Martin, "Facebook Shares Bounce 8 percent", USA Today, 26 November 2012.
[140] See J Boorstin, "Why Facebook's Stock Soarded on Biggest Lock-Up Expiration", CNBC, 14 November 2012.
[141] See A Wilhelm, "Analyst Upgrades Push Facebook's Stock Up 5 percent, Nudging Its Market Cap Back Over the $60 Billion Mark", The Next Web, 2 January 2013.
[142] See R Wauters, "Facebook's Stock Price Soars Past $30, Its Highest in Nearly 6 Months", The Next Web, 9 January 2013.
[143] Indeed, there seem to be consensus among equity research analysts that Facebook will outperform the market. Apparently, this has been the consensus forecast since 29 may 2012. See www.ft.com. Not all analysts are positive. They point to the continuing mobile advertising problems. See C Thompson, Why Facebook's Lock-Up Surge Won't Last, CNBC, 14 November 2012.
[144] See S Chakrabarty and M Lewis, "Facebook Stock Avoids Steep Drop As Street Rethinks Results", Reuters, 31 January 2013.
[145] See N Vardi, "Facebook's February Flop", Forbes, 28 February 2013.
[146] See J Van Grove, "Mark Zuckerberg Promises Not to Sell A Single Facebook Share For At Least A Year", VentureBeat, 4 September 2012.
[147] See V Wong, "Why Employees Like Zuckerberg (and Other Popular CEOs)", Bloomberg Businessweek, 18 March 2013.

The conclusion is that the stock market tends to react negatively to signals that indicate a decrease in a firm's growth potential.[148] From the above discussion, we can already distinguish three categories of signals: (1) increased competition, (2) insiders selling shares, and (3) negative analysts sentiment. If we look at our data, we propose adding an additional category: changes and revisions in expectations. The question is: What can companies do to deal effectively with a negative stock price performance and volatile price swings. This is an important question, because a positive IPO performance will attract prospective investors, decrease the cost of capital and make it easier to acquire and retain talented employees with 'retention tools', such as restricted shares and stock options.[149] Clearly, the acquisition and retention of employees is key to ensuring future growth and value creation. In the next Sections, we will discuss two 'tools' that companies may consider to generate a better IPO or stock market performance.

3. Board Dynamics and Composition

Empirical studies of high potential growth companies, such as Facebook, indicate that they tend to follow a pre-determined life cycle. It typically starts with turning an idea into a start-up company. From this perspective, the start-up company will first attempt to raise capital from family, friends and fools (who are willing to invest in an extremely risky business).[150] In order to survive the 'valley of death' (which can be defined as the period between the initial capital contribution and the time the company starts generating a steady stream of revenue), the start-up then attempts to attract follow-on investments from angel investors and venture capital funds. Typically, these venture capitalists prefer to have board seats on their portfolio companies. Also, venture capitalist board members are not only supposed to control and monitor the CEO's and other executive managers' actions, but provide value-added services that help bring the company and its entrepreneurs to the next stage of the development. Prior research has typically indicated that venture capitalists as board members in start-up companies can be quite beneficial, because they usual have expertise in the general areas of governance and financing, but they usually also have experience and knowledge about product development, sales strategy and talent search.[151] Generally, entrepreneurs appreciate the contributions of venture capitalist board members. They acknowledge that in order to have a great business, it is necessary to have an engaged board that is interactive, candid, and passionate.[152] This

[148] Conversely, the stock market tends to react positively to signals that indicate an increase in a firm's growth potential.
[149] See F Salmon, "Why Jeff Bezos Cares About His Share Price", Reuters, 1 February 2013.
[150] Recently, other sources of initial capital have made it easier to find financial support. Consider here the growing importance of incubators and crowdfunding, an internet-based approach to raising capital, in the first stages of a company's life. See K Colleran, "Start With Family, Incubators and Crowdfunding Sites", Wall Street Journal The Accelerators, 15 January 2013.
[151] See E Mendel land M Jeffers, "A Seat at the Table", A Study of Venture-Backed Company Boards, DowJones and NVCA Presentation, 2005.
[152] See M Blumberg, The Good, The Board, and The Ugly, Only Once, 25 July 2004.

suggests that, in order to be engaged, board members need to be strategically (not operationally) involved and understand the fundamental dynamics and drivers of the business.[153] Ideally, their involvement continues until shortly after the moment that private investors decide to exit the company by floating it on the stock exchange (or selling it to another company).[154]

Given our understanding of board expertise, quantitative research shows that having venture capitalists (with their specific expertise and experience) on the board has a positive effect on the IPO performance of young listed companies.[155] Interestingly, the positive sentiment about boards of directors slowly but surely changes in the post-IPO world. For instance, controversial Silicon Valley celebrities, such as Oracle's co-founder Lawrence J. Ellison, have openly heralded the move towards dual class share structures.[156] In an interview, Mr. Ellison stated that brilliant entrepreneurs should protect themselves against indifferent boards that have no real interest in the company, do not care about the sector it operates in nor understand its technical and long-term prospects. He gives the example of Steve Jobs who got fired after a power struggle with Apple's board in 1985. As noted above, conventional corporate governance experts disagree with Mr. Ellison. They do not believe that creating dual class share structures provide the answer.[157] As we have discussed, these structures are prone to severe agency problems that result from the separation of beneficial ownership (or cash flow rights) from control rights (or voting rights). We extend our previous discussion by pointing out some of the alleged shortcomings of these devices. First, proponents argue that these structures undermine the accountability of an owner/founder/CEO to the board of directors or supervisory board. The board is basically a 'toothless' tiger because the owner/founder/CEO can overrule any board decision. Second, the lack of accountability contributes to an increase of information asymmetries, which in turn may lead to corporate failure and a decrease in investor confidence. Third, the relatively young and untested owners/founders/CEOs, supported by their venture capitalists and investment banks, often create governance organizations that are not in line with the check and balances promoted by corporate governance experts.

In response to these limitations, consider again Facebook's corporate governance practices at the time of the IPO. After Facebook filed its first prospectus, experts immediately started to warn investors (and other stakeholders) about its all-male board, the high number of venture capitalists on

[153] See M Blumberg, The Board of Directors: Guest Post From Matt Blumberg, AVC Musings of a VC in NYC, 23 April 2012.
[154] Please note that most high potential companies do not follow the traditional life cycle. Trade sales (acquisitions by financial or strategic investors) are currently the most important and even preferred exit for private investors. See JM Mendoza and EPM Vermeulen, supra n 12.
[155] See S Chahine and M Goergen, "VC Board Representation and IPO Performance", (2011) 38 Journal of Business Finance and Accounting 413.
[156] See AlthingsD, D10 Video: Steve Job's Career Lessons, 30 May 2012.
[157] See P Davies, "Facebook IPO: Analysis: Like It – Or Don't", The Daily, 18 May 2012.

the board, and the combined CEO/Chair role of Mark Zuckerberg.[158] Moreover, it was stressed that Facebook's dual class share structure makes it a 'controlled company' under the corporate governance rules for NASDAQ-listed companies.[159] This entails that it is not required to have a majority of independent directors. Also, it is not necessary to have a compensation committee or an independent nomination committee.[160] To be sure, Facebook's board has only decided not to have an independent nomination function. Instead, the full board, which currently complies with the 'majority of independent directors' rule, is involved in nominating new board members. Clearly, this deviation should not worry investors too much. However, shareholders of Facebook should be mindful that Mark Zuckerberg has the discretion to dismiss the independent directors and replace them with inside/non-independent directors in the future, which, of course, would reduce the checks and balances that are usually available to shareholders of listed companies.[161]

But even with the majority of Facebook's directors being independent, corporate governance experts doubted whether the board is able to play an important role in the checks and balances of Facebook. In fact, Facebook's board was facing mounting criticism for allegedly not being able to adequately protect shareholder value and monitor management closely.[162] From the experts' point of view, the board was not only a toothless tiger, but it was also too homogeneous in the sense that it is mainly composed of Silicon Valley veterans, particularly male venture capitalists with similar viewpoints.[163] This lack of diversity could lead to group think and tunnel vision, which obviously would have a negative impact on the adequacy of management oversight and internal controls within the company.[164] It should therefore come as no surprise that corporate governance experts, after having taken notice of Facebook's corporate governance and supported by women's advocacy groups,[165] have paid an unusual amount of attention to gender equality.[166] They were of the opinion that the

[158] Facebook does not have a classified board. This entails that the directors will be elected for annual terms. The prospectus, however, clearly states that the fact that the Class B shareholders lose their majority will trigger the establishment of a classified board of directors consisting of three classes serving staggering three-year terms.

[159] See NASDAQ Rule 435(c)(5). Controlled companies are companies in which more than 50 percent of the voting power for the election of directors in held by an individual, a group or another company.

[160] See, for instance, Davis Polk & Wardwell LLP, Corporate Governance Practices of U.S. Initial Public Offerings (Controlled Companies Only), October 2011.

[161] See D Bigman, "Facebook Ownership Structure Should Scare Investors More Than Botched IPO", Forbes, 23 May 2012.

[162] See Facebook's Board Reveals 2 Major Flaws, Seeking Alpha, 29 June 2012.

[163] See D Primack, "Ann Winblad: Too Many VCs on Facebook Board", CNN Money, 21 August 2012.

[164] See M Lückerath-Rovers, "Homogeneous Board = Groupthink = Risk", LEAP, 7 October 2009.

[165] See B Bosker, "Facebook Protesters Demand Social Network Add Women to All-Male Board", The Huffington Post, 25 April 2012.

[166] See NP Flannery, "Why Long-Term Investors Are Worried About Facebook's Lack of Board Diversity", Forbes, 12 February 2012. See also K Swisher, "The Men and No Women of Web 2.0 Boards (BoomTown's Talking to You: Twitter, Facebook, Zynga, Groupon and Foursquare)", AllThingsD, 21 december 2010.

appointment of women on the board could bring the much-needed balance back in the boardroom, which was needed to better serve the interests of the majority of Facebook's female users.[167]

The efforts were not in vein. On Monday, 25 June 2012, just months after the IPO, Facebook named Ms. Sandberg as its eight board member.[168] Because Ms. Sandberg already joined Facebook as chief operating officer in 2008, Mark Zuckerberg viewed her as a perfect fit for the board.[169] Moreover, she had been a feminist champion who publicly advocated for women to become more involved in leadership positions within tech companies.[170] But the corporate governance experts were not satisfied. Accordingly, the action of appointing a company insider did not have the desired effects. They continued to voice their disapproval of Facebook's board being too clubby.[171] To be sure, the appointment of Ms. Sandberg was a step in the right direction. However, she was also a Silicon Valley insider. In view of the intensified efforts of corporate governance experts to increase the number of women on boards of listed companies, it was therefore not surprising that Facebook announced the appointment of a second female on the board in March 2013.[172] Ms. Desmond-Hellmann, who is currently chancellor of the University of California (San Francisco), is the ninth director of Facebook. Her experience as former president of product development at biotechnology giant Genentech, where she worked together with Facebook's chief financial officer, certainly adds to the board's diversity.[173] Or as Mark Zuckerberg put it: '[Ms. Desmond-Hellmann] has a great track record of building and managing a diverse set of organizations, so her insights will be valuable as we continue to expand into new areas'.

Based on the above discussion, there is something to Facebook's decision to appoint Ms. Desmond-Hellmann as a member to its board of directors. An analysis of the VC-70 companies as well as the FT-40 companies seems to indicate the prominence of board diversity. It should be noted, however, that age and gender diversity appears to be less important than diversity in expertise.[174] For instance, it appears from Tables 3 and 4 that the average age of the directors in FT40 companies is significantly higher than in VC-70 companies. The reasons for this are straightforward. First, the directors of the

[167] See M Forbes, "Facebook's Lack of Boardroom Diversity: Why Not Use Facebook to Change Facebook", Forbes, 8 February 2012.
[168] See B Bosker, "Sheryl Sandberg Joins Facebook Board Of Directors – The First And Only Woman To Do So", The Huffington Post, 25 June 2012.
[169] See A Dembosky, "Sandberg Is First Woman On Facebook Board", The Financial Times, 26 June 2012.
[170] See A Ignatius, ""Now Is Our Time" – An Interview with Sheryl Sandberg", Harvard Business Review, April 2013.
[171] See S Raice and JS Lublin, "Sheryl Sandberg Joins Facebook Board", The Wall Street Journal, 25 June 2012.
[172] See T Bradshaw, "Facebook Appoints Second Female Director", The Financial Times, 6 March 2013. See M Isaac, "Former Genentech Exec Susan Desmond-Hellmann Joins Facebook's Board of Directors", AllThingsD, 6 March 2013.
[173] See T Geron, "Facebook Names Susan Desmond-Hellmann To Board Of Directors", Forbes, 6 March 2013; B Womack, "Facebook Names UCSF Chancellor Susan Desmond-Hellmann to Board", Bloomberg, 7 March 2013.
[174] Interestingly, a closer look at the FT-40 data set shows that the appointment of women on the board also increases the diversity in expertise and experience. This is confirmed by B Groom, "Females Add Diversity to Boards", The Financial Times, 3 Mach 2013.

FT-40 companies (compared to the directors of the VC-70 companies) have also served for a longer period on the board. Second, board members are usually recruited from the network of the existing board members, which often consist of people of the same gender and age group.[175] Still, tables 3 and 4 reveal that the companies in both data sets take diversity seriously. For instance, most companies in our data sets have boards that consist of members not only with general business expertise (which is usually met by the presence of other CEOs or former CEOs), but also include financially literate people (accountants, CFOs or former CFOs). Consistent with our general observations in Section 2, however, it could be advisable to add more general and financial sophistication to the board of 'young' IPO companies.

What is more important from the diversity perspective is that the board also selects quite a number of individuals with substantive knowledge of particular industries, sectors and/or markets.[176] It is remarkable to see that a significant number of board members in our data hold academic positions, particularly in the area of biotech, medicine and engineering. This is also true for the FT-40 companies where 35 percent of the analyzed boards of directors appointed one or more academics. In fact, their presence can be invaluable to identify technical issues and opportunities.[177] As we already discussed earlier, another notable observation is the number of private investors or venture capitalists that were appointed in the boards of directors of the FT-40 companies. From the perspective of the increasing importance of corporate venturing activities (as well as the three-dimensional corporate governance model), the awareness of their value-added contributions is beyond any doubt. It is only to be expected that this number will rise in the near future.[178]

Interestingly, Facebook's board upgrades did not seem to have had an immediate effect on its IPO performance. From a traditional corporate governance perspective, this could be easily explained by the fact that in order to restore investor confidence, Facebook's corporate governance structure must ensure a truly independent board. Thus, as long as Mark Zuckerberg is the CEO, chairman and controlling shareholder, Facebook has strong institutional safeguards against dissenting views in the boardroom. There is simply no room for a diverse array of viewpoints on Facebook's board. So the obvious question arises: Should Facebook split the roles of chairman and CEO to regain investor confidence and deal with the stock price volatility? From the perspective of the risk oversight

[175] Strong support for this view is provided by the FT-40 data set. It is striking to see that board members usually hold the same additional positions in other profit and non-profit organizations. See also WG Bowen, supra n 108.
[176] This number is higher in the VC-70 companies. However, we observe that the more mature companies increasingly understand the importance of board diversity.
[177] See WG Bowen, supra n 108.
[178] Arguably, venture capitalist board members play a crucial role in assisting executive managers (usually the CEO, CFO or CTO (Chief Technology Officer)) to create a corporate culture in which the established (or to be established) corporate venturing unit can thrive. See J Von Heimburg, "Driving Innovation by Corporate Venturing: How to Master Governance and Culture Challenges", Innovation Management, 7 January 2013.

responsibility, the answer is yes. In practice, however, the one-person CEO-chairman model may be the preferred way of working since it avoids disharmony, conflicts and time-consuming ambiguous leadership issues.[179] If we look at Table 5, it appears that the one-person model is the preferred model in the VC-70 companies.[180] However, if we link the board leadership models to the IPO performance of the VC-70 companies, we come to a surprising conclusion. It appears that the 'separation of CEO and chairman' model is extremely powerful, if the founder or an experienced venture capitalists take the chairman position. Recall the board structure of LinkedIn, where Reid Hoffman is the chairman and Jeff Weiner is the CEO. How should Marc Zuckerberg proceed? Should he be encouraged to replicate the LinkedIn structure? Perhaps, but this should currently not be their main focus if Facebook wishes to promote long-term growth.[181] We argue in the next Section that more attention to the investor relations' strategy may have a stronger and quicker effect on Facebook's stock price performance than their choice of governance structure.

Table 3: Board Composition and Diversity VC-70 companies (independent directors only) on 31 December 2012

Diversity Indicators	*Average*	*Median*	*Max.*	*Min.*
Number of Directors (total)	8 members	8 members	12 members	5 members
Number of Independent Directors	6 members	6 members	10 members	3 members
Age	54.2 years	54 years	85 years	27 years
Time on the Board	4.8 years	4.7 years	21 years	0 years
Women on the Board	< 1 member (0 members (49%) / 1 member (47%) / 2 members (4%)	1 member	2 members	0 members
General Expertise	< 1 member (0 members (51%) / 1 member (33%) / 2-3 members (16%)	0 members	3 members	0 members
Financial Expertise	< 1 member (0 members (49%) / 1 member (43%) / 2 members (8%)	1 member	2 members	0 members
Business Expertise	< 2 members (0 members (13%) / 1 member (43%) / 2-4 members (44%)	1 member	4 members	0 members
'Former' VCs	< 3 members (0 members (7%) / 1 member (13%) / 2-5 members (80%)	2 members	5 members	0 members
'Independent' Investors	< 1 member (0 members (61%) / 1 member (25%) / 2 members (14%))	0 members	3 members	0 members

[179] See WG Bowen, supra n 108.

[180] It should be noted, however, that 40 percent of the companies that incorporated the one-person model also appointed a lead director to balance the power within the boardroom.

[181] Recall that stakeholders are very happy with Mark Zuckerberg as CEO of Facebook.

Table 4: Board Composition and Diversity FT-40 companies (independent directors only) on 31 December 2012

Diversity Indicators	*Average*	*Median*	*Max.*	*Min.*
Number of Directors (total)	13 members	12 members	20 members[182]	7 members
Number of Independent Directors	9 members	10 members	16 members	0 members
Age	61 years	61	92 years	35 years
Time on the Board	7.7 years	7,5	43 years	0 years
Women on the Board	3 members	3 members	5 members	0 members
General Expertise	4 members	4 members	9 members	0 members
Financial Expertise	2 members	2 members	4 members	0 members
Business Expertise	2 members	2 members	7 members	0 members
Investors/VCs	1 member	1 member	4 members	0 members
CEO=Chairman	35%			
Chairman=Insider	42.5%			
Chairman=Outsider	22.5%			

Table 5: Who Is The Chairman?

Who?	*Percentage (on 31 December 2012)*	*IPO Performance (31 December 2012)*		
		Average	Max.	Min.
Chairman = Founder + CEO	27%	22%	363%	-76%
Chairman = CEO	23%	-24%	71%	-74%
Chairman = Founder	13%	23%	155%	-76%
Chairman = Former VC/CEO	20%	12%	150%	-90%
Chairman = Outsider	17%	-22%	98%	-86%

4. Investor Relations

If you ask experts to give a response to Facebook's corporate governance choices, they will tell you that one of the most important reasons for the poor IPO performance of Facebook and other social media companies is the failure of the founders and its advisors to adequately appreciate and understand how good corporate governance can improve the effectiveness of the organization, revenue generation and investor (and other stakeholder) satisfaction. The conclusion is that fast growing (social media) companies should take corporate governance more seriously. Certainly, companies can forestall or destroy an otherwise successful trajectory with a terrible and non-transparent corporate governance structure. In light of the three-dimensional corporate governance model, however, it is far from clear that companies – large, medium-sized or small – can guarantee success after they have endorsed 'one-size-fits-all' state of the art corporate governance practices, including transparency and accountability towards all stakeholders. This is clearly the conclusion of the Facebook story. It appears that investors and other stakeholders looked right through the governance structure of Facebook at the time of the IPO – despite the risk factor warnings in the

[182] Due to co-determination requirements, the German companies in our data set have relatively large boards of directors.

prospectus and the worrying media attention. The rising valuations on SecondMarket and the high IPO price reflected the optimism in the growth potential of Facebook.

Undoubtedly, it is crucial that the promising expectations about the growth prospects be based on accurate and timely information. This is also an important lesson that we can derive from Facebook's IPO. To see this consider the US Securities and Exchange Commission's Regulation FD,[183] which addresses selective disclosure of information by listed companies. Generally, a listed company is prohibited from making selective disclosure of nonpublic material information to certain individuals or entities. The Regulation contains an exemption from the public disclosure requirement for registered offerings, making it possible for companies and their advisors that are in the process of an IPO to selectively disclose information and forecasts to prospective investors on road shows.[184] Facebook's lead underwriter, Morgan Stanley, had allegedly given this exemption a broad interpretation.[185] When one of its investment bankers heard from Facebook's chief financial officer on 7 May 2012 that the financial forecasts were lower than earlier communicated to investors he advised to disclose this information selectively and gradually. The details are complex, so we will simply give an overview of the measures proposed by Morgan Stanley and their lawyers. First, Facebook filed an amended prospectus on 9 May 2012 at 5:03 pm. New language (and no numerical forecasts) was included in the risk factors section of the prospectus, pointing out that mobile advertising prospects were behind expectations. As a second step, Facebook's treasurer started to call analysts in the evening of 9 May 2012 to ensure that they were aware of the amended filing. During the calls she was using a script prepared by Morgan Stanley. Third (and consequently), the equity research analysts, including the analysts affiliated to the lead underwriters, Morgan Stanley, JP Morgan and Goldman Sachs, adjusted their revenue estimates down. Their reports were subsequently shared verbally with big institutional investors. The retail investors were left in the dark.

The result was a failed IPO with only losers. As mentioned earlier, the biggest losers were the retail investors.[186] Unaware of the deteriorated forecasts (because they had not read the prospectus or had not comprehended the added warning) were lining up to buy Facebook shares in anticipation of a big pop.[187] They bought overvalued shares and lost an estimated $630 million in the first days after

[183] See 17 C.F.R. § 243. 100 to 103.
[184] See J Weil, "Morgan Stanley's Farcical Facebook Settlement", Bloomberg, 21 December 2012.
[185] See H Blodget, "EXCLUSIVE: Here's The Inside Story Of What Happended On The Facebook IPO", Business Insider, 22 May 2012; See H Blodget, "REVEALED: The Full Story Of How Facebook IPO Buyers Got Screwed", Business Insider, 20 December 2012; Jim Edwards, Morgan Stanley Allegedly Used This Weird Trick To Dodge Rules On Facebook IPO, Business Insider, 19 December 2012.
[186] See JC Coffee, The 10th Anniversary of the Sarbanes-Oxley Act, Hearings Before the Subcommittee on Capital Markets and Government Sponsored Entities of the Committee of Financial Services of the United States House of Representatives, 26 July 2012.
[187] See O Oran and A Barr, "Facebook Prices At Top Of Range In Landmark IPO", Reuters, 17 May 2012.

the IPO.[188] The second loser was Facebook. The continuing negative post-IPO performance will eventually take its toll on its capability to attract new investors and retain talented employees (who are necessary to reach Facebook's growth aspirations). At the same time, Morgan Stanley could be considered the third loser. However, it is questionable whether the payment of $5 million to settle allegations for improperly influencing equity research analysts will stop underwriters and analysts to make selective disclosures regarding deteriorating performance expectations to favored institutional investors before the IPO in the future.[189]

What could Facebook do to improve upon its IPO performance? Investor relations' specialists know the answer: Facebook should embrace more transparency with respect to their growth expectations and engage in information sharing.[190] Ironically, it is suggested that it should use Facebook or other social media to target retail or institutional investors and, more importantly, equity research analysts.[191] The Apple-case, discussed in Section 2, also confirms the importance for growth-oriented companies to actively interact with the stock market, thereby paying particular attention to the equity research analysts. Indeed, when we compare Apple with Facebook, we notice some interesting similarities. The stock price performances of both companies suggest that they face an investor relations' challenge to keep investors informed and willing to hold long positions in the companies. In the remainder of this Section, we will discuss the options for Facebook.

When analyzing the data on investor relations' strategies we come to the conclusion that Facebook really stands out from the VC-70 companies' data. While most companies actively engage with investors by making presentations at investor conferences organized by investment banks,[192] Facebook is not a regular participant in the conference circuit (see Table 6). Are there any plausible explanations for Facebook's behavior? The literature on IPOs suggests that it is generally paramount for companies that recently floated their shares to generate trading volume. Because these companies usually lack a track record, they trade less often and in smaller volume. This entails that their stock price is particularly responsive to buying and selling pressures, which, in turn, increases the cost of capital. Low trading volume is often the explanation for a depressed stock price and negative IPO performance. Ultimately, there are strong incentives for 'young' IPO companies to

[188] See J Horowitz and O Oran, "Facebook Flop Hurst Small Investors' Trust In Stocks", Reuters, 25 May 2012.
[189] See A Lucchetti and J Eaglesham, "Morgan Stanley Gets Facebook Fine", The Wall Street Journal, 18 December 2012.
[190] See N Stewart, supra n 37.
[191] See V Jindal, "Facebook Must Use Facebook to Friend Investors", CNNMoney, 25 May 2012.
[192] Here it should be noted that we acknowledge that there are other means to identify, reach and interact with institutional as well as retail investors. For instance, the data shows that the VC-70 companies often reach out to investors through investor relation firms. For instance, 19% of the VC-70 companies used investor relations firms The Blueshort Group to assist them with their IPO. Moreover, companies also interact with investors through earnings conference calls and one-on-one meetings. See Capital Markets Board, Investor Relations – Best Practices – Interviews With Executives, Special Report #6.

generate trading volume by communicating with the market and attracting the interest of equity research analysts (see Figure 2). The more trading volume the company has, the easier it is to receive analyst coverage and institutional sponsorship.[193] Thus, there is no surprise why biotech companies and clean-tech companies, which usually do not receive the same media-attention as their Internet and social media counterparts, are already active in the investor conference circuit in the first month after their IPO (see Table 7). The results also suggest that companies that have attracted pre-IPO media coverage generally consider participating in investor conferences when the IPO performance deteriorates or starts to deteriorate.

Table 6: Investor Conferences

Companies	*Investor Conference 2012 (Average)*	*Max.*	*Min.*
VC-70 Companies	6	35	0
FT-40 Companies	7	34	0

Table 7: Timing of Investor Conferences (during the first six months after the IPO)

IPO Performance	*Av. First Day: 22%*	*Av. 30-Day: 21%*	*Av. 60-day: 27%*	*Av. 6 months: 11%*
Investor Conferences	-	9	34	122
Which companies participate in investor conferences?	-	Biotech: 39% Clean-tech: 37% Services: 16% Internet: 8%	Services: 22% Biotech: 18% Clean-tech: 14% Semicon.: 14% Software: 14% Internet: 8% Other: 10%	Biotech: 17% Clean-tech: 16% Medical: 15% Internet: 14% Software: 11% Services: 10% Other: 10% Semicon.: 7%

An alternative to this scenario is Facebook's behavior. One possible explanation for the reason that the company had avoided investor conferences was that it was able to take advantage of the hype created around its IPO. On 31 December 2012, its '50-Day Average Daily Volume' was 68,957,574 shares. This in turn enabled the company to receive equity research coverage from 40 sell-side analysts (which is significantly more than the average number of 9 analysts that covered the VC-70 companies on 31 December 2012). Thus it is no surprise that there was less need to communicate clearly with stock market participants. In other words, the best decision was to focus on just executing on the business. It is important to note that there is more to participating in investor conferences than just being able to generate trading volume. In fact, it is a tool to disseminate

[193] See AJ Epstein, *The Perfect Corporate Board, A Handbook For Mastering The Unique Challenges of Small-Cap Companies*, (New York: McGraw-Hill, 2013). See also P Roosenboom, F Schlingemann and M Vasconcelos, Does Stock Liquidity Affect the Incentives to Monitor? Evidence from Corporate Takeovers, Working Paper, April 2013.

information about a company's growth prospects, which, if communicated well, may have a positive impact on the stock price development.[194]

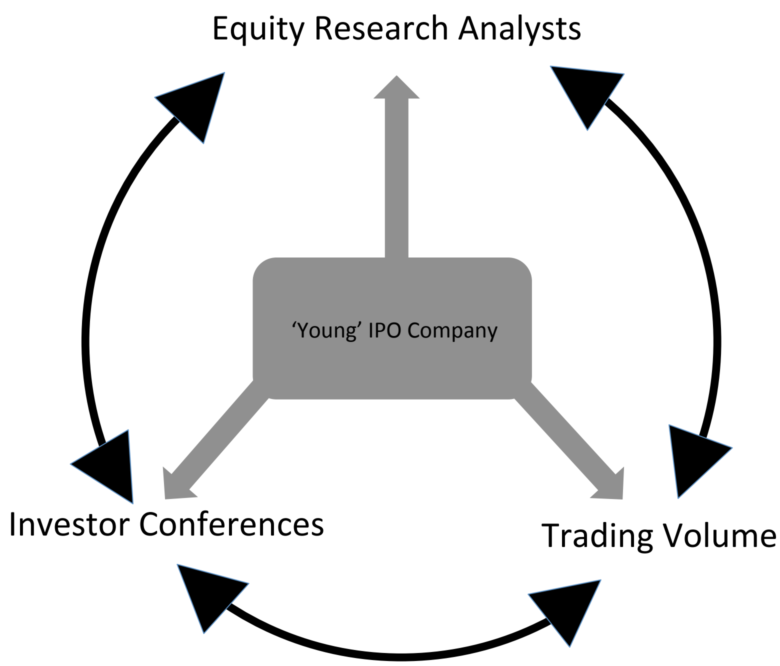

Figure 2: The IPO Conundrum

These conferences, organized by investment banks, usually have a clear focus on products and product markets. Consider LinkedIn's participation in the 'Goldman Sachs Technology and Internet 2012 Conference' on 27 February 2012 or LinkedIn's keynote presentation at the 'Bank of America Merrill Lynch Technology Conference' on 9 May 2012. Specifically, the presentations are not so much about financial statements (that focus on the past), but rather involve an interactive discussion about the introduction of new products, product innovations and/or entering new markets. Possibly the most important aspect of these conferences is to connect presenting and participating corporations (that are interested in improving their stock price performance by marketing their shares) together with leading institutional investors across the globe. However, a similar focus is on the opportunities offered to participants to not only get a better sense of their peers and larger competitors that often attend the same events, but also to attract attention from media, retail investors and customers. Indeed, the interactions at investor conferences between the company on the one hand and its potential investors and equity research analysts on the other are often also available and 'visible' to

[194] This will, in turn, put more value on employee retention tools, which will make it easier to attract and retain talented employees with the skills and expertise to meet the growth potential of the company. In this respect, it is not surprising that Facebook decided to participate in the Morgan Stanley Technology, Media & Telecom Conference on 27 February 2013.

the company's other stakeholders through (1) live webcasts and replays of the sessions through the company's investor relations website and (2) detailed articles in the both mainstream consumer, business and financial media.[195]

Based on the above, we propose that participating in investor conferences today is also likely to be a form of competitive advantage for companies (see Table 8). Firms are provided an outside opportunity that enables them to connect with governments, investors and other companies. According to such logic, this also explains the high participation rate of FT-40 companies in investor conferences (see Table 6). While we expect that more firms be willing to participate in these conferences, an increase in the number of firms beyond a certain threshold will lead to diminished returns. Moreover, while firms are more likely to generate more information about themselves for investors, there is no guarantee of success for many firms. Consider Velti, a UK company in the mobile advertising and marketing industry. Velti switched from the Alternative Investment Market (AIM) in London to NASDAQ in January 2011 to gain status as a listed company. The IPO price was $12 per share. Even though the company participated in 12 investor conferences in 2012 it could not prevent the drop in its stock to $4.66 on 31 December 2012, resulting in a negative IPO performance of 71.12 percent.

Table 8: Investor Conferences and Growth

Advantages of Investor Conferences	*Direct or Indirect Effects on Growth and Value Creation*
Trading volume Equity research coverage Less volatile	Lower cost of capital – Institutional investors Higher value retention tools – attracting and retaining talented employees
Interaction with analysts and institutional investors	Raising awareness of blind spots in growth strategy
Media coverage	'Visibility' to other stakeholders

Research on IPOs suggests that it is often difficult to change this downward trend. In developing a solution to their declining prospects, many companies may make varying attempts to build new relationships at conferences by providing investors with information about new products and growth prospects. Notice that the presence of companies at too many investor conferences (which could be perceived by the market as a distraction from the business) or communicating the wrong message at investor conferences could pose greater problems and perhaps only make things worse. In addition, participation in such conferences may increase, for example, short interest activities pursued by

[195] See, for instance, http://investor.fb.com/releasedetail.cfm?ReleaseID=741921. See also J Van Grove, "Facebook CFO calls Instagram a 'formidable competitor', CNET, 27 February 2013. Clearly, the 'visibility' of the information shared at investor conferences takes away some of the worries that institutional investors obtain superior information about a company. See M Subasi, Investor Conferences and Institutional Trading in Takeover Targets, Working Paper, 18 November 2011.

investors' betting against a company's stock price.[196] Already clear is the fact that a high short interest may be strongly associated with poor communication strategies. This is reflected in Figure 3, which shows that the frequency of attending investor conferences is related to short selling activities. There are two possible explanations: (1) companies can stem short interest by increasing their attendance to investor events in order to improve their communication with investors or (2) an increasing number of poor presentations increase short-selling activity.

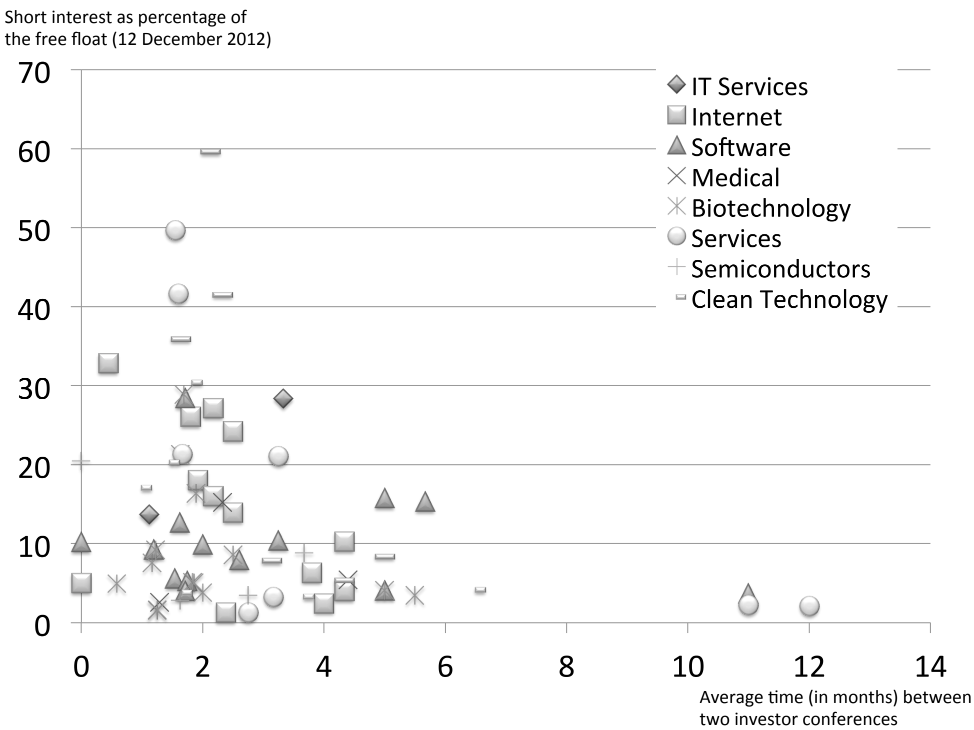

Figure 3: Investor Conferences and Short Interests

Finally it is worth noting that companies should not underestimate the power of investor relations' strategies. Both empirical work and interviews reveals that participating in investor conferences is arguably a 'best practice'. In addition, our findings do not suggest a specific one-size-fits-all approach for the frequency and type of presentations made at investor conferences. On the one hand, Internet radio company Pandora makes two presentations every month. On the other hand, LinkedIn limits its participations to investor conferences to about one investor conference every 3-4 months. Our results indicate that firms strive in different ways to supply information regarding their growth potential in order to enhance investor perceptions and bring new resources to the firm.

[196] See N Summers, "Hedge Funds' Hail Mary: Bet on Tech", 10 December 2012.

IV. Conclusion

In this paper, we analyze the underlying factors that differentiate two main corporate governance models: (1) the 'shareholder wealth maximization' model and (2) the 'long-term commitment' model. While acknowledging the force of combining the two approaches into a two-dimensional model of corporate governance, we show that the need for a third dimension, which focuses on growth and value creation, was demonstrated to recognize that some governance factors may be influential in yielding beneficial consequences for listed companies. It is important to reiterate that one of the advantages of the three-dimensional model of corporate governance is that the responsibility for implementing structures that limit agency costs, encourage long-term commitments and promote entrepreneurship and innovation clearly lies with the companies themselves.

The second part of the paper provides important insights in practices and strategies that could promote entrepreneurship and innovation in their organizations. We show that it is a daunting task to define best practices. However, a strong focus on board dynamics and investor relations can give companies a clear competitive advantage. For instance, a well-functioning (and innovative) investor relations' strategy is not only key in building strong relationships with investors, but is also a tool to connect with other companies, employees and customers. Surprisingly, board dynamics and investor relations are often ignored in the corporate governance debate. The research detailed in this paper shows that corporate governance has a much bigger role to play in the creation of growth and business value than initially thought.

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