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Google Baloney


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Google's founders don't want to go public, their company doesn't need the money, but they're going public anyway. Why? To create a "liquidity event," an opportunity for the founders, employees and venture investors to cash out some of the wealth they've been working for.

Being a sucker in somebody else's liquidity event, of course, is not the sort of invitation investors normally leap at. Yet that's the role IPO investors frequently volunteer themselves to play. In turn, Wall Street underwriters have traditionally seen their job as setting the IPO price low enough so those who ante up will be rewarded with first-day profits when the stock trades up -- not just as a bribe, but as a token of good faith.

Yes, this tradition got out of hand in the Internet bubble, when new companies tripled or quadrupled in the first day. Bankers can hardly be faulted for pricing an IPO at a level reasonably related to a company's earnings and prospects. Blame investors: They're the ones who behaved strangely. Nor does Google solve this problem with its much-touted auction plan, which on closer inspection is somewhat faux. The company will indeed solicit bids over the Internet but reserves the right to set a final price by the visible hand of its owners and bankers. How come? Google and its bankers fear big institutional money will stay away unless assured of a first-day pop.

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Mr. Jenkins joined the Journal in May 1992 as a writer for the editorial page in New York. In February 1994, he moved to Hong Kong as editor of The Asian Wall Street Journal's editorial page. He returned to the domestic Journal in December 1995 as a member of the paper's editorial board and was based in San Francisco. In April 1997, he returned to the Journal's New York office. Mr. Jenkins won a 1997 Gerald Loeb Award for distinguished business and financial coverage.

Born in Philadelphia, Mr. Jenkins received a bachelor's degree from Hobart and William Smith Colleges in Geneva, N.Y. He received a



Larry Page

But at least the auction method will (presumably) be a neutral allocator of shares, with none of the gross cronyism present in traditional IPO allocations. For that, Google's leaders deserve a round of cheers.

What else set tongues a flapping was Google's decision to issue two classes of stock, giving its founders, Larry Page and Sergey Brin, as well as CEO Eric Schmidt, super-voting shares worth 10 times the voting weight of an ordinary share. As the prospectus frankly states, the goal is to entrench insiders in control of the company. Cofounder Larry Page's celebrated Buffett-like letter is devoted mainly to explaining why this favor to himself is really in the interest of you, the potential shareholder:

master's degree in journalism from Northwestern University in Evanston, Ill., and studied at the University of Michigan on a journalism fellowship.

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Because we'll be able to focus on the long term without worrying about short-term pressure from Wall Street. Moralizing about the long term versus the presumably disreputable and unvirtuous short term is mostly an evasion of real issues. The stock market is perfectly capable of taking a long view -- witness the share prices of firms that Google hopes to keep company with, such as Yahoo and Amazon, which enjoy huge valuations compared to current earnings precisely because the market is betting on long-term potential.

We won't have to play the quarterly earnings game. Investors value not just potential but also achievement, and have been known to award higher share prices to companies that set and meet earnings targets reliably. You can be sure that if Google decides it can benefit from a predictability premium, it will start offering earnings guidance to the Street.

"We provide many unusual benefits for our employees, including meals free of charge, doctors and washing machines. . . . Expect us to add benefits rather than pare them down over time." The Googlers don't mention the \$800 heated toilet seats. Investors will have to judge whether such bennies are genuine productivity builders -- or whether they count as "on-the-job consumption," one of the "private benefits of control" that academic economists traditionally regard as the motive for voting-power lockups. To translate, that's a nice way of saying insiders are living it up at shareholder's expense.

We bridge the media and technology industries . . . which have experienced considerable consolidation and attempted hostile takeovers. Dual-share companies have become more common lately as founders seek to entrench themselves after going public. No wonder. A study of proliferating dual-share companies in Canada found that 44% of firms listed on the Toronto exchange fell prey to a battle for control at some point during an 11-year period. Takeover threats are a fact of life here too. Ironic case in point: Disney, a one-share, one-vote company assailed by Comcast, in which the Roberts family controls 1% of the shares but 33% of the votes.

"Dual class structures have not harmed the share price of companies." If there's no cost, then why don't all companies avail themselves of the advantages Googlers see in the dual-share structure? In fact, a

recent study by Harvard's Paul Gompers and Joy Isshi and Wharton's Andrew Metrick finds that such companies have reduced share valuations, and invest less in R&D and advertising. The authors conclude with the suspicion that a "misalignment of incentives leads dual-class firms to invest too little, leading to lower sales growth and valuations."

We aim to "make the world a better place" and fulfill the company motto "don't be evil." Nobody fails to couch his or her motives in the higher good.

In sum, potential investors would be wise to discount the Google blather and focus on what the founders themselves say is their motive: keeping control. But equally true, Google is owned by its owners, and they have every right to offer an interest to the public on whatever terms suit them. Fifteen years ago, a court tossed out an SEC attempt to ban dual-share issues, and quite properly, because there's no compelling public interest to justify such interference in the property rights of company owners.

Finally, we cannot help but be delighted in the reaction to Google presenting its business results with large deductions for the non-cash "cost" of employee stock options. As did a writer in Barron's over the weekend, analysts everywhere simply undid the deduction to get a more accurate picture of Google's underlying profitability (not to mention the real tax rate on its profits). If this is not dispositive of the practical silliness of the whole debate on expensing, we don't know what could be.

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