

Case Study - Facebook

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Company Overview

Facebook is a website which allows users, who sign-up for free profiles, to connect with friends, work colleagues or people they don't know, online. It allows users to share pictures, music, videos, and articles, as well as their own thoughts and opinions with however many people they like.

How Facebook Silences Its Investors

The latest round of scrutiny and outrage over Facebook's FB business practices has lots of fingers pointing in Mark Zuckerberg's direction. But one important voice has long been muffled at the company: shareholders.

The way Facebook stock is structured, Zuckerberg essentially has complete veto power over other shareholders when it comes to the company's shareholder votes. Just this year alone, Zuckerberg has been able to beat back efforts by other shareholders who have asked the company to report both on its efforts to combat child sexual exploitation through its products and on its efforts to fight its use as a home for disinformation, hate speech, and the incitement of racial violence.

Investors often don't think about it, but shareholders are the owners of a company. A chief executive officer--even as a founder--is just as much an employee of the company as anyone else who shows up to work. That's why there are corporate boards, which are supposed to act as elected shareholders' representatives. (At Facebook, Zuckerberg is both CEO and board chair, a situation that shareholders have tried to change, but he also voted that down.)

Shareholders get to voice their opinions of company management and key business issues through proxy voting. At most companies, one share equals one vote.

But at Facebook, it's a different story. Some shareholders--mainly Zuckerberg--are "more equal than others," as George Orwell once wrote.

The Facebook shares that you and I, along with big investors like mutual funds, can buy are Class A shares, of which there are roughly 2.4 billion in the market. We get one vote for each share. But Zuckerberg and a select group of others own Class B shares, which afford them 10 votes per share. There are roughly 440 million Class B shares.

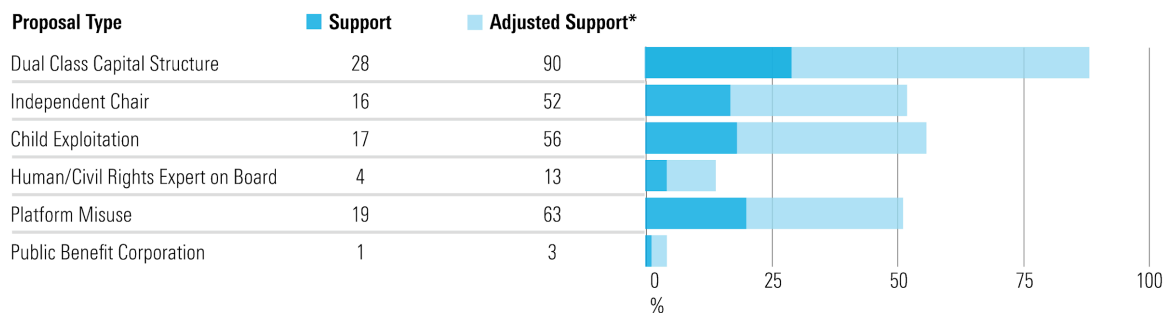
Zuckerberg personally owns nearly 360 million Class B shares, and through agreements with other Class B shareholders, controls the vote of another 32 million. That gives him control of some 392 million Class B Shares, some 90% of the total.

Facebook isn't alone in having super-voting rights on some share classes. The ranks of those companies include Warren Buffett's Berkshire Hathaway BRK.A, Alphabet (aka Google) GOOGL, and Lyft LYFT.

But Jackie Cook, Morningstar's director of investment stewardship research, calls Facebook "an extreme example" in disenfranchising other shareholders.

One way to see the impact Facebook's share class structure has in silencing shareholders is to consider how the results on shareholder resolutions would have looked without the Class B share votes.

How Facebook's Share Structure Affects Vote Results



Source: Morningstar's Proxy Database. Data as of Sept 30, 2021.

*Adjusted support excludes the votes controlled by Mark Zuckerberg

Take the proposal that asked the Facebook board to assess the risk of increased child sexual exploitation as the company develops additional privacy tools such as end-to-end encryption. This proposal by shareholder-advocacy firm Proxy Impact on behalf of Lisette Cooper, the vice chairman of Fiduciary Trust International, a unit of Franklin Templeton. Cooper has shared that her daughter was groomed by a predator on Facebook.

When all votes were counted, the proposal only received 17% support, with 980 million votes in favor and 4.7 billion against. That would seem to be a clear rejection of that proposal. However, if the Class B shares are excluded--remember Zuckerberg controls 90% of them--the resolution would have received majority support at 56%.

Largest U.S. Facebook Owners

	Shares (Millions)	Index Tracking	Weight in Portfolio
Vanguard Total Stock Market Index Fund	67.7	Yes	2.0%
Vanguard 500 Index Fund	50.1	Yes	2.4%
Fidelity® Contrafund® Fund	41.9	No	10.6%
American Funds Growth Fund of America	40.7	No	5.1%
SPDR® S&P 500 ETF Trust	25.1	Yes	2.1%
Fidelity® 500 Index Fund	22.8	Yes	2.4%
T. Rowe Price Lg-Cap Core Gr Strat-UBS	22.1	No	7.5%
T. Rowe Price Blue Chip Growth Fund	22.1	No	7.5%
Invesco QQQ Trust	20.5	Yes	3.7%
Vanguard Growth Index Fund	18.7	Yes	4.0%

Source: Morningstar Direct. Data as of September 30, 2021.

Proxy impact is expected to refile its proposal.

Sustainalytics' corporate governance analyst Denisa Ghita notes that Facebook goes even further than most other companies with that share class structure, with provisions limiting board independence and shareholder rights that kick in should the voting power of Class B shares drop below 50%. Should that happen, the board of directors becomes classified, meaning the company will no longer have annual board elections and shareholders will have the right to remove directors only for "cause." Plus, stockholders would be deprived of what is known as the right to act by written consent, which allows for shareholder action outside of a shareholders' meeting. Should they come into play, these provisions would "make the current governance structure even less shareholder-friendly," Ghita says.

Cook notes that the argument is sometimes made that super-voting rights help certain types of young companies avoid short-term earnings pressures while pursuing growth early on after their IPOs. The Council of Institutional Investors, she notes, has said that, while a single class of shares is the optimal, it is reasonable to have a maximum seven-year sunset provision in place on dual class share structures. Even under that scenario, Facebook would have ended its dual class structure in 2019.

Another response to share class structures like those at Facebook is: "If you don't like it, then don't own the stock."

That's a simplistic way to look at the question and ignores one obvious problem: Facebook, because of its size, is a major holding in many index funds, where selling the company's stock is not an option. In fact, based on holdings data in Morningstar Direct, roughly 18% of Facebook stock is held in index-tracking fund strategies around the world. (That percentage doesn't include index-based strategies held in other kinds of accounts, such as institutional portfolios.)

In the United States, for example, six of the 10 largest mutual fund holders of Facebook shares are index funds.

In fact, just Vanguard and BlackRock combined hold about as many shares as Zuckerberg. But the share class structure effectively nullifies the voice of their investors.

From a broader, stock investors' perspective, senior equity analyst Ali Mogharabi writes that, "Our main knock on Facebook's management is its use of multiple class structures that may limit the voice of minority shareholders. This has become more of an issue given how Facebook is addressing data privacy and security, which has led to some shareholders wanting to reduce Zuckerberg's control of the company. Some continue to believe that Zuckerberg's control of Facebook may result in significant conflict of interest depending on his future strategies and whether they generate exceptional returns for shareholders, as they have in the past."

For now, Mogharabi believes that negative headlines over its policies will likely keep Facebook under pressure, but from a valuation standpoint, shares are currently undervalued.

The share class structure has deterred at least one shareholder activist for now. Jonas Kron, chief advocacy officer at Trillium Asset Management, who has introduced a number of shareholder proposals to separate Facebook's chairman and CEO roles, says Trillium is no longer a shareholder--it once held \$12.8 million worth of the stock--partly because Zuckerberg and his voting bloc, "has been resolutely opposed to any meaningful governance reforms." He notes that Zuckerberg has repeatedly apologized for the company's failures and said that it is his responsibility to fix them, but he has failed to do so. "Relinquishing control is a cornerstone of the company moving forward."

Facebook faces renewed push to split CEO, chairman roles amid controversies

[Facebook Inc.](#) founder Mark Zuckerberg will face renewed calls from investors to ease his iron grip on the company after another wave of scandal engulfed the social network operator.

Shareholders in 2022 will seek to split the roles of CEO and chairman, both currently held by Zuckerberg, to create an independent chair seat, marking the fourth year in a row for such a proposal, according to Illinois State Treasurer Michael Frerichs, who is helping to lead the push. Calls for greater oversight have grown after whistleblower

Frances Haugen revealed that Facebook management was aware of how its platforms have harmed some users.

"This is not their first scandal, and it's not going to be the last," Frerichs said. "We've been talking about the governance transparency issues for years."

The difficulty for minority investors is that Zuckerberg is able veto efforts to boost investor oversight because of a two-tier share structure that gives him almost 58% voting control over the company. Similar proposals in 2017, 2019, 2020 and 2021 all failed, despite winning support from institutional investors, including the likes of Vanguard Group Inc., AllianceBernstein Holding LP, The Bank of New York Mellon Corp., The Goldman Sachs Group Inc. and JPMorgan Chase & Co. Behind Zuckerberg, Vanguard is Facebook's second largest shareholder, owning 182,466,282 shares, or 6.5% of common shares outstanding, as of June 30.

"Unfortunately, because of the dual-class structure of the votes, we've been unsuccessful" in breaking up the two positions, Frerichs said.

Top 10 Facebook stockholders

Holder	Common stock equivalent held (actual)	Percent of common shares outstanding	Market value (\$B)	Change in shares from previous reporting (actual)	Position date
Mark Elliot Zuckerberg Founder, Chairman & CEO	350,417,522	12.43	114.04	-4,223,900	10/06/21
Vanguard Group Inc.	182,466,282	6.47	62.59	-690,513	06/30/21
BlackRock Inc.	155,424,508	5.51	53.31	-2,521,819	06/30/21
Capital Research & Mgmt Co.	135,726,332	4.81	46.56	4,384,484	06/30/21
FMR LLC	123,891,184	4.39	42.50	1,821,054	06/30/21
T. Rowe Price Group Inc.	101,398,075	3.60	34.78	-3,149,975	06/30/21
State Street Global Advisors Inc.	92,196,339	3.27	31.62	319,155	06/30/21
Eduardo Saverin	53,463,148	1.90	18.34	0	03/31/21
Geode Capital Management LLC	38,810,686	1.38	13.31	1,030,274	06/30/21
Norges Bank Investment Management	28,797,824	1.02	9.88	0	12/31/20

Data compiled Oct. 12, 2021.

Derivatives excluding 60 days data is only available from annual reports.

Market value is calculated using the closing price \$343.01 as of Oct. 1, 2021.

Sources: Company filings; S&P Global Market Intelligence

Governance 101

Still, Zuckerberg's role at Facebook is becoming more of a lightning rod for both activist shareholders and regulators. Environmental, social and governance investors are turning against the company because the recent scandal — centered on teen mental health, and Facebook's use by human traffickers and drug cartels — has exacerbated concerns about the company's management structure, said Natasha Lamb, managing partner at sustainable investment firm Arjuna Capital.

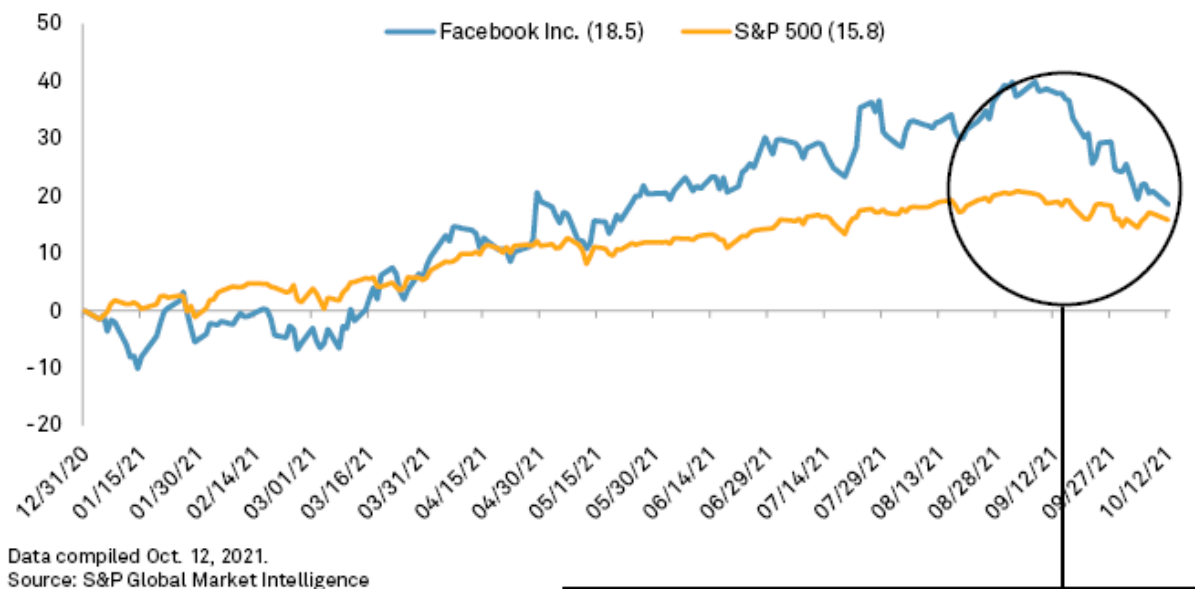
"It's Corporate Governance 101 that you separate the chair from the CEO," she said, noting the desire to disassociate with the social media company will not be limited to just ESG investors.

Facebook did not respond to requests for comment from S&P Global Market Intelligence about investor concerns. It has publicly said it is taking steps to divert users away from harmful content and give parents more control over teen Instagram accounts.

In its 2021 proxy, Facebook said Zuckerberg's control allows the company to focus on long-term success rather than short-term stock movement. Under Zuckerberg's leadership, Facebook has grown from serving only select college campuses to reaching 2.90 billion global monthly active users, according to its second-quarter 2021 earnings release. The stock has surged 750% since Facebook's IPO in May 2012, and the shares have still outperformed the S&P 500 Index this year, even with the recent sell-off. Since the end of August, Facebook's shares were down almost 15% as of market close Oct. 12.

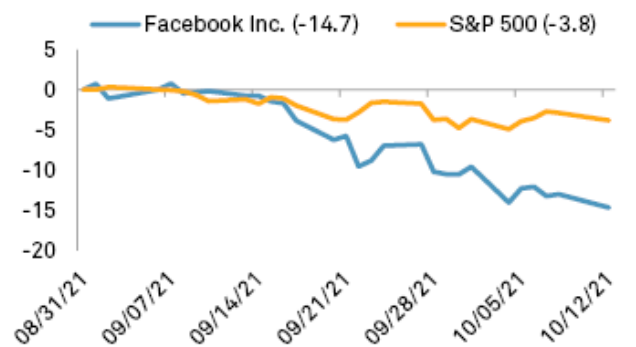
Facebook's stock price performance, 2021 YTD (%)

Stock price change from Dec. 31, 2020, through Oct. 12, 2021



Facebook shares slump amid whistleblower revelations

Stock price change from Aug. 31, 2021, through Oct. 12, 2021 (%)



Supervoting shares

Zuckerberg retains control of Facebook through Class B shares, which come with 10-to-1 voting rights. Class A shares — the type that public shareholders may buy — have one vote per share.

These dual-class share structures are not uncommon among tech companies. Alphabet Inc., Lyft Inc. and Pinterest Inc. have all issued two types of shares that favor founders and insiders. Alphabet and Lyft have split the CEO and chairman roles, while Pinterest, like Facebook, has not.

Zuckerberg is likely to face increasing pressure given the specter of increasing regulatory scrutiny. The company is already fighting a [legal battle](#) with the Federal Trade Commission that could force Facebook to divest its Instagram, LLC and [WhatsApp Inc.](#) assets.

"I think there's enormous regulatory risk that has been served up because of inaction on his part," Lamb said of Zuckerberg. "He is the king on the throne, and that's why Congress and the FTC are getting involved."

Facebook could also see increased litigation from state attorneys general and class action suits, according to New Street Research Policy Advisor Blair Levin. He pointed to past lawsuits against tobacco companies and drug makers, and noted these lawsuits would create an opportunity for expensive settlements that would address the issues more quickly than legislation.

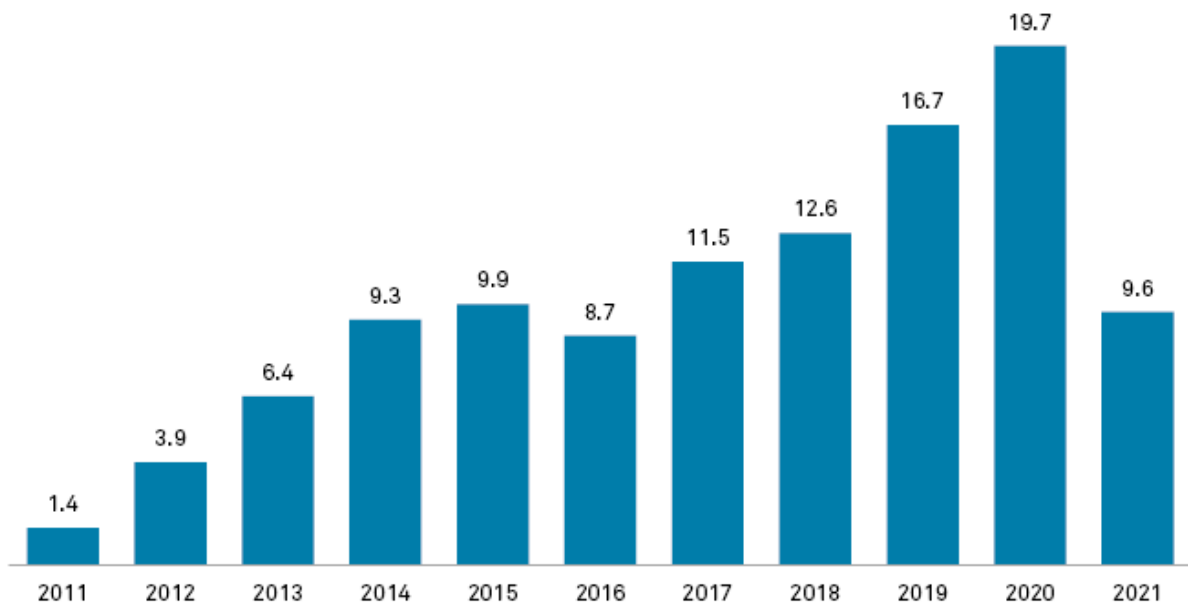
Path forward

Facebook has a strong public policy team to contend with this scrutiny, said Scott Kessler, global sector lead for TMT at investment research company Third Bridge. Its openness to discussing regulatory issues, such as [reforming](#) the Section 230 online liability shield and supporting a [global minimum tax](#), has served as a good strategy for framing the company in a positive light, Kessler added.

The company's focus on legal and regulator risks, as well as its surging growth, has helped fuel a more than 10-fold jump in the company's [lobbying spending](#) over the past decade. Expenditures totaled \$19.7 million in 2020, and it spent another \$9.6 million in the first half of 2021, according to OpenSecrets.org, a website tracking money in U.S. politics.

Facebook's year-end lobbying spending throughout decade

Lobbying expenditures (\$M)



Data compiled Oct. 11, 2021

Third-quarter lobbying data was not filed by time of publishing; third-quarter filing deadline is Oct. 20, 2021.

Source: OpenSecrets.org

Illinois' Frerichs expects Facebook to spend even more on lobbying and PR because of the on-going scandals. Still, the company and its founder need to do more than just saying the right things in the middle of a crisis, he said.

"It isn't enough for Facebook to say that it embraces transparency, honesty and civic integrity," he said. "As the face of the organization, it is up to Zuckerberg to actually operationalize those words."

Facebook boss reveals changes in response to criticism

Facebook boss Mark Zuckerberg has revealed a series of changes to the firm's portfolio of social platforms, including Instagram and Whatsapp.

The new designs and features for its apps are a direct response to widespread criticism of how the firm protects user data.

Mr Zuckerberg said the company plans to put privacy first.

He acknowledged that there was much to do to rebuild trust.

In a speech to developers, Mr Zuckerberg described the firm's new focus on privacy as "a major shift" in how the company is run.

Some of the more visible changes to those who use the firm's products will include:

- Messages sent via Messenger will be end-to-end encrypted by default, meaning Facebook itself won't see the contents, and the platform will be fully integrated with WhatsApp
- Instagram is trialling a "private like counts" feature which would hide the "likes" a post attracts from viewers, but not the account owner
- There will be more "ephemeral" ways to share content in messages - meaning there will not be a permanent record of them
- A WhatsApp secure payment service trialled in India is to be rolled out to other countries later this year.
- The Facebook app is being redesigned to make community groups central to the newsfeed - and the distinctive blue branding is going. The redesign is rolling out in the US and then more widely straight away.
- Instagram posts will no longer have to start with a photo or a video, it will be possible to share content using just text, stickers or drawings thanks to a new "create" camera mode.

"The future is private," Mr Zuckerberg said - adding, in a nod to the tech giant's stream of privacy scandals: "I know we don't have the strongest reputation on privacy right now, to put it lightly".

He said Facebook was focused on looking at ways to encode privacy across the firm's entire infrastructure.

"It's not going to happen overnight and to be clear we don't have all the answers," he said.

He has previously said that he believes that people will want to talk privately in small groups and communities in the future.

However he will have to convince the public that Facebook is the place to do this, some commentators noted.

"The big question is how it will perform in a regulated social media world in 2019 and beyond," said social media consultant Matt Navarra.

"My verdict: it will go the distance and bounce back, but its reputation will remain in tatters for years to come."

References

[BBC](#)

[Morning Star](#)

[S&P Global](#)