Snap's IPO

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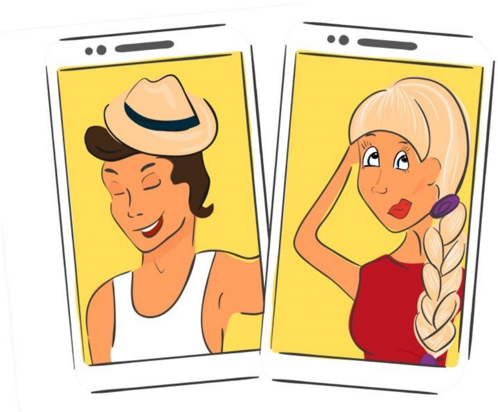

We all know Snapchat, the app that displays a picture (snap) taken with a mobile phone. The sender can choose for how long — between 1 and 10 seconds — the receiver can view the image. After the selected time frame, the snap disappears from the recipient's screen unless he or she had enough time to take a screenshot. Snapchat is popular among young people because the sender has better control of where the picture ends up since it's difficult to copy the image and share it on other social networks.

Now Snapchat is on its the way to the stock market with a valuation of $25bn. It is the fifth largest IPO among tech companies in the United States since 2000 (1). Despite the valuation Snapchat has large and increasing losses. Net profits in 2016 amounted to minus $525m combined with a negative cash flow of $678m (2). Hence, to cover the losses and pave the way for future business development, Snapchat intends to attract $3mdr new capital.

However, what is particularly interesting is that the founders Evan Spiegel and Bobby Murphy want to protect their ownership and control of the company by offering new shareholders a class of shares without voting rights. We are in some jurisdictions used to seeing different classes of stock with different voting rights, e.g., A-shares with ten votes/share and B-shares with one vote/share, but having a class of shares with no votes at all is something entirely new. Two related issues are whether board members appointed by the shareholder without voting rights should have any right to vote on board decisions and whether, with no voting power, there will be different levels of exposure to responsibilities among the directors of the board.

Most venture capitalists and institutions require "one share, one vote," and several US pension funds have sent letters of objection to Snapchat. They also see an overall risk that this IPO may open "the floodgates" to similar corporate governance arrangements around the world (2).

The Snapchat IPO has exposed divergent views and opinions among investors and entrepreneurs in Silicon Valley. We need to recognize the importance of founders and entrepreneurs being motivated and having an attractive financial upside in the value creation of the business. On the other hand, it is not particularly exciting for a new investor to inject significant capital without gaining any control at all. It increases risks and, thus, the required higher return on capital. Increased risk and return expectations will, in turn, have an adverse effect on the company's valuation.

It will be interesting to see whether Snapchat's IPO will be successful and it they are able to issue new shares with no voting rights. In any case, it is an exciting and attractive company connected with a significant risk.

Source:

1. *Dealogic*
2. *Financial Times*