Goldman Sachs Will Survive Saga

By John F. Sandy Smith

Remember the rule in grade school where a child wants gum or candy, and the teacher says, "I hope you brought enough for everybody?" That's the sentiment many have about Facebook's recent $1.5 billion private placement deal led by Goldman Sachs. But unfortunately for disappointed investors, bringing enough for everybody is not the law, and it's not business.

The controversial deal, and a widely-publicized last-minute surprise, provide a peek under the covers of the challenges of a high-growth company and the desire to invest in what many see as a sure thing. It also sheds light on who will, and won't, be able to share in Facebook's profits

The Facebook/Goldman deal was a match-up of two super-powers: the overwhelmingly-dominant social media company and the overwhelmingly-dominant investment bank. Each represents the gold standard in their respective areas, providing something no one else can. Plus, each employs the best and brightest people. In other words, if you were a high-powered businessperson who received a call from either one, you'd take it.

First of all, for good reason, large private placements such as the Facebook's $1.5 billion infusion seem to be the investment vehicle "du jour." They are replacing the stock market initial public offering (IPO), which has been many investors' best chance of sharing the wealth. Instead of the average person being able to buy stock, it is only available to extremely high-wealth individuals.

Large companies see real advantages to private placements. For Facebook, these include the lack of legal scrutiny, transparency and government regulation that go with an IPO. It also lets the

social media dynamo keep its powder dry and attract talent by offering stock options while still raising money. Finally, Facebook can run its business in a private, and perhaps long-term or opportunistic, way. (Some point out the irony of this, given the openness of Facebook's philosophy and product.)

For Goldman, it means significant fees for arranging the private placement without the costs of working with other bankers. It could also offer plum Class A Facebook common stock, which was in high demand, to its best customers.

But Goldman had second thoughts about the legal ramifications of offering shares within the United States. Its statement said it concluded that the level of media attention "might not be consistent with the proper completion of a U.S. private placement under U.S. law. The decision not to proceed was based on the sole judgement of Goldman Sachs and was not required or requested by any other party. Goldman Sachs regrets the consequences of this decision..."

Goldman's concerns apparently included that the Facebook deal, among other things, blurred the lines between a public and private offering in the U.S. The late decision to offer stock only outside the U.S. (even though it had reportedly already distributed information to eager potential buyers) became an even bigger story: only non-U.S. investors would be able to buy a chunk of an American company valued at $50 billion. Large U.S. investors were left out. Remember – there is no IPO, so small U.S. investors were never in the game. Finally, some have questioned the valuation of the securities sold in the private placement as too high. Within days of the announcement, Goldman completed the oversubscribed offering overseas - another example of its global prowess. After all, if they are passing it out, who would not want a piece of candy?

What happens now? Each company heard a significant outcry from disappointed potential investors. The size and scope of a private offering such as Facebook may also attract more attention from Washington and the news media because it raises questions about public policy that allows companies to raise large amounts of cash with little regulation. It also raises concerns that only the wealthy and sophisticated were allowed to invest. But conversely, it could also be used as an argument that less regulation allows for a more efficient allocation of capital.

Facebook will definitely make the transition. Its day-to-day users will continue to find it convenient and useful, and even more new customers will sign up. However, Facebook's formal announcement of the deal on Jan. 21 said that even before the Goldman investment, it expected to reach 500 shareholders this year. That means it would have to file public financial reports by April of 2012. Therefore even though it's not public yet, we may learn more about it than we ever have before.

Goldman will also do just fine, though it faces challenges on the heels of low earnings and intense government scrutiny of Wall Street. Goldman will continue to invest heavily in its relationship with its large U.S. clients (who may expect Goldman to make it up to them a bit.) While they may be more inclined to take calls from its competitors, chances are good that Goldman's clients will continue to use Goldman the same way users will continue to use Facebook; each will remain a dominant player in its industry.

So where does this leave the two leading franchises today? Both Goldman and Facebook will continue as sought-after market leaders in all aspects. While their competitors have no doubt enjoyed the drama, it's unlikely that either titan will be unseated. And while the deal got attention for bypassing small investors, it is neither the first –nor the last – time it will happen. It

is actually a part of a growing trend that has no end in sight. So don’t count on being “friended” with candy any time soon.

Sandy Smith is a corporate and securities attorney with Womble Carlyle Sandridge & Rice, PLLC, in Atlanta.

This article originally appeared in the Atlanta Journal-Constitution’s “Business Voices” section on January 30, 2011.