Facebook's IPO – A Disaster, or Just a Bad Flip of the Coin?

Mark Zuckerberg, Facebook's CEO, had long resisted going public. But SEC rules require a public offering and public trading when the number of shareholders exceeds 500. By 2012, Facebook was approaching this limit as a result of shares granted to employees and investors, including Microsoft and Digital Sky Technologies, who had purchased equity stakes in private transactions.

The IPO was announced in February 2012 and scheduled for May 18, 2012. Excitement built up as that day approached. Some investors remembered how LinkedIn's share price climbed over 100% on its IPO day. Facebook was an even bigger, more glamorous, and so far more successful company. There were skeptics, however, who worried about slower growth in EPS and the extremely high price-earnings multiple at the likely offering price.

Facebook's CFO, David Ebersman, and its lead underwriters, Morgan Stanley, JP Morgan, and Goldman Sachs, had set a range of $28-35 per share for the IPO price but settled on $38 per share. Ebersman was "intent on making sure that Facebook didn't leave money on the table."[1] In other words, he was trying to avoid, or at least limit, IPO underpricing. He also decided to increase the number of shares offered by 25%. The IPO would raise $16 billion.

Initial trading was marred by NASDAQ computer glitches – many investors could not execute orders promptly or could not confirm that orders went through. Nevertheless, trading volume on the IPO day was 460 million shares. The stock price did not take off, however, but closed at about the $38 offering price, despite price support from Facebook's underwriters.

Then the price went steadily downhill, trading as low as $20 per share in August 2012. Did that low price really mean that the IPO was a "debacle," as some have claimed?

Suppose that a CFO sets his or her company's IPO so that no money is left on the table. That means getting the price right on the IPO day. If the price is right on that day, there is roughly a 50% chance that the price will be lower a month or two later, and roughly a 50% chance that it will be higher. That's what happens in an efficient market. That's what happens any time you buy shares of any company, including Facebook post IPO. A decline in price after you buy doesn't mean that the price you bought at was wrong. You buy and fate and the market flip a coin – sometimes it comes up tails.

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[1] A. R. Sorkin, "The Man behind Facebook's IPO Debacle," *New York Times*, September 3, 2012. (http://dealbook.nytimes.com)