The We Company

BSC IN INTERNATIONAL BUSINESS

CORPORATE GOVERNANCE EXAM: 48 HOUR INDIVIDUAL HOME ASSIGNMENT

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Introduction

The much-anticipated IPO of The We Company (WeWork) was supposed to be the largest one of the year, but the shared office group was sent into chaos after investors failed to buy into the 47 billion dollar valuation. Upon filing for the IPO, much scrutiny was put on the business model and governance framework that had been put in place, and as things developed investors became more and more concerned. In the center of it all was co-founder, chairman and former CEO Adam Neumann (Neumann), who had been a visionary entrepreneur working towards “elevating the world’s consciousness” (we.co, 2019). The IPO has been called off and US business editor for Financial Times, Andrew Johnson, said that “WeWork went from this mythical unicorn valued at 47 million dollars, to something looking a bit more like a donkey with a paint job and an ice cream cone stuck on its head”(Clark, Johnson, 2019).

By looking at the ownership, board and management structures within the company, this report seeks to identify the overarching governance problems that led to WeWork’s IPO failure and analyze how recent changes in governance will affect the company in the future. A recommendation as to what we, as a major shareholder, can do to turn things around will be put forth.

Ownership structure[1]

WeWork runs a dual class[2] equity system with three classes of common stock (A, B and C). Class A stock comes with cash flow rights and voting rights (one share one vote), class B has cash flow rights and high-vote rights (10 votes per share), and class C only has high-vote rights (10 votes per share). The Class A common stock is held by a combination of institutional investors and private equity funds (Appendix 2), with Softbank being the largest blockholder. Other large holders of class A stock include Benchmark, which is wholly owned by Bruce Dunlevie (director at WeWork), J.P. Morgan and WE Holdings LLC, where Nuemann has sole voting power of all shares. Class B common stock is almost exclusively held by WE Holdings LLC, consequently giving Neumann majority voting right and thus making WeWork’s ownership concentrated. Class C common stock is held exclusively by Neumann. (SEC, 2019)

It is evident that Neumann, as one of the founders, has put several control enhancing mechanisms in place, in order for him to gain outside capital but keep majority influence. The most important being the dual class equity system, which has efficiently locked up Neumann’s control of the company. The initial prospectus for WeWork’s IPO reported that class B and C stock were classified as “high vote” stocks, carrying 20 votes per share. This huge difference in voting power increases the potential for agency problems between minority and majority shareholder, as it gives no influence to minority shareholders. To mitigate this, voting power on B and C stocks was lowered to 10/1 in the amended S1 filing. This effectively changed nothing and can be seen more as a symbol,

[1] Amounts of shares can be seen in appendix 1

[2] Dual class being defined as any system were shares are differentiated.

than an actual attempt to divide power more equally between shareholders. Neumann has since then, according to sources, agreed to reduce the power of his voting shares to 3/1, no longer giving him the majority voting control.

If this is true, it can be seen as a step in the right direction from a governance perspective, as the former ownership structure had proven to create too many problems. These changes will help to decrease the possibility of agency problems within the shareholders, as control is more balanced now (Steen Thomsen, 2019). These changes will furthermore enhance our influence in the company, which can be detrimental in the efforts to turn the negative development around.

Board structure

WeWork operates with a one tier board which currently consists of 7 members, all of whom are non-executive and five of whom are independent according to NASDAQ regulations. Appendix 3 provides an overview of the board composition. The board is not very diverse in terms of background and gender, as all current directors are men with experience within finance or marketing. This can lead to increased cohesiveness and increased monitoring capacity, but can also increase groupthink as well as limit the range of board competencies (Steen Thomsen, 2019). As Neumann decided to step down as CEO, there is no longer CEO duality within the board. This will help mitigate the management challenges that resided within the firm but will also increase the possibility of agency problems and will definitely raise agency cost due to increased monitoring.

WeWork's corporate governance is strengthened by the apparent independence of the board. However, the board is not as independent as it seems. The filing states that, Bruce Dunlevie, Ron Fisher, Lew Frankfort, Mark Schwartz and John Zhao are all independent. Taking a closer look at each of the directors reveals that all them has had ties to WeWork prior to the directorship, making it questionable whether or not they are independent[3]. The possible lack of independency coupled with Neumann's power position as owner, chairman, and at the time CEO, seems to have had major implications for the effectiveness of the board prior to the IPO filing. Signs of entrenchment have been evident, as Neumann has used to his power to exert private benefits, furthering his own interests rather than the interest of the shareholder. The board's role as an internal monitor has seemingly been non-existent, consequently leading to a vast amount of governance problems within other branches of the business[4]. As beforementioned, many of the board members are experienced within finance, so how were none of them able to see the growing problems in regard to the business model? It might be the case that Neumann's power position has created a conformity bias, where Neumann's consensus might have become group consensus, that no one dares to oppose.

[3] According to the UK governance code

[4] This will be further elaborated upon in the next section

Subsequently, there have been no internal reporting frameworks or committees to keep checks and balances, solidifying the monitoring problems within the firm.

All this results in an ineffective board that has not been value creating for the shareholders. The IPO filing suggests that some changes will be made upon the completion of the offering. An additional board member, Frances Frei, has been selected to join the board of directors. This will increase gender diversity but will not solve the independency problem, as she will join as a dependent director(O'Brien, 2019). Furthermore, WeWork plans to establish an audit committee as well as a compensation and nominating committee. Though these initiatives are steps in the right direction, we have to be aware of the dysfunctional board structure as well as the potential for increased agency problems between manager and board.

Management

WeWork has since the beginning and up until the offering been managed by co-founder Adam Neumann, who has taken the company from being a simple start-up to becoming the largest real estate tenant in major cities like New York and London. Neumann has through his charisma and salesmanship, been able to revolutionize the office market in a way that many did not think was possible. Consequently, Neumann was involved in everything within the company, and appendix 4 shows how he was is a direct reference to all decisionmakers within WeWork.

Following the IPO filing, focus began to arise around Neumann and his many dealings within WeWork. His excesses, his demand for control and peculiar governance arrangements became apparent, and cases of bad governance began to pile up. Sexual harassment, potential nepotism, exerting private benefits and taking up loans in the company are just some examples of how Neumann had taken advantage of his position in the company to perform moral hazard. Furthermore, Neumann has been accused of creating information asymmetries by reclassifying expenses in the prospectus to make unit economics look better (Singer, 2019). All these cases exemplified the bad governance within WeWork and made investors lose interest, consequently making Neumann resign his position as CEO.

Two new CEOs have been appointed, Artie Minson and Sebastian Gunningham, both being described as steadying forces (Morris, Holmes, 2019). With new management comes new governance issues that we should be aware of. Having co-CEOs increases the agency costs because you now have to monitor/incentivize two CEOs instead of one. Moving away from the owner/manager structure also implies a shift in governance perspective. Neumann had a stakeholder perspective where he cared more about purpose and people than about the product (Clark, Johnson, 2019). With the employment of the new CEOs, this perspective has now changed to a shareholder perspective, where shareholder value is the focus. This has already become apparent as WeWork reportedly has plans of letting 2000 employees go in efforts to reduce costs (Rushe, 2019). The new management is consolidating rather than expanding and has in those efforts created immediate type 3 agency problems. The new management has furthermore closed the WeGrow branch of the company, which focused on teaching kids about entrepreneurship and innovation. Again, creating type 3 agency problems, but it is also worth considering whether culture is at risk? We should as a major shareholder consider this aspect, especially in a company that has been built on a foundation of a strong culture.

The path to failure

WeWork's failure to go public cannot be attributed to a single event but rather a chain of events that has left the company flawed. The ownership structure has made it possible for WeWork to grow at an enormous pace the last couple of years, but as revenue has skyrocketed so has the losses. Having majority voting power, has given Neumann the opportunity to keep expanding without any accountability towards the shareholders. Subsequently, the information asymmetries have been growing and opacity increased, as the managerial entrenchment has rendered the boards monitoring role obsolete. The huge loses coupled with the opacity of the firm, made it difficult for investors to analyze the company. When companies become difficult to analyze, the trust of the management team become more important. As investors looked at the management team, essentially Neumann, to see if he was someone they could trust, that is where things started to unravel. A flawed governance framework, as well as a potentially flawed business model in the end made the investors back out of the IPO.

Recommendation

In the light of recent events it has become clear that the issues in WeWork's governance framework are extensive. Several steps have to be taken in order for the company to turn the negative development around and become attractive to new investors. In this process, We need to consider our role as an institutional investor. Does increased activism necessarily lead to positive effects? Theory prescribes that the optimal level of activism depends on owner competence (Steen Thomsen, 2019). We might have competencies within tech, but we need to reevaluate whether or nor WeWork falls under this category. Subsequently, the issue that we should focus on is a governance issue, and our resources within this field are limited. Before engaging in increased activism, we should therefore set up a small team of governance specialists to provide expertise during this turnaround. Having done that, the following recommendation should be considered.

- Stay committed as an active shareholder. We have already incurred considerable agency cost in relation to the failed IPO, but the costs of a bankruptcy will far outweigh these. We are too committed to not do anything and without our help WeWork might be on the verge of bankruptcy. That being said, the ownership structure would have to change. Sources have already reported that Neumann has agreed to degrade his voting powers, effectively removing his majority voting rights. We need to push for this to happen. This would consequently break up Neumann's power position, which will be helpful in dealing with other governance issues. It would in addition give minority shareholders more influence, making it more attractive for outside investors to invest.

- Employ tighter governance framework with stronger focus on monitoring. The management has already been changed, but theory suggests that it is not management but the structures surrounding it that is detrimental to change in governance (Gilson & Kraakman, 1991). New structures should be put in place to secure proper monitoring mechanisms. And audit committee should be put in place, even if the firm does not go public. This will strengthen internal reporting and help keep checks and balances. This will increase agency costs, but these will be considerably lower than those incurred during times, where such structures were not in place. These structures will also help increase financial transparency and thereby lower information asymmetries.

- Restructure and diversify board. The board has been an integral part of the failing governance framework within WeWork and has also been criticized for its lack of diversity. As mentioned earlier in the report, the board has been inefficient in its role as a monitor and consequently not value creating. The board members need to be reevaluated in terms of their contribution and what value they bring. A change is needed and here new board members with "true" independence and more diversity should be sought after. There are already plans of adding a female to the board if the offering is successful. This should be done either way. A study of women's impact in the board room, identified that women are tougher monitors than male directors (Adams & Ferreira, 2009). Consequently, gender diversity on boards makes for a valuable asset in firms with weak governance. ¨

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Appendix

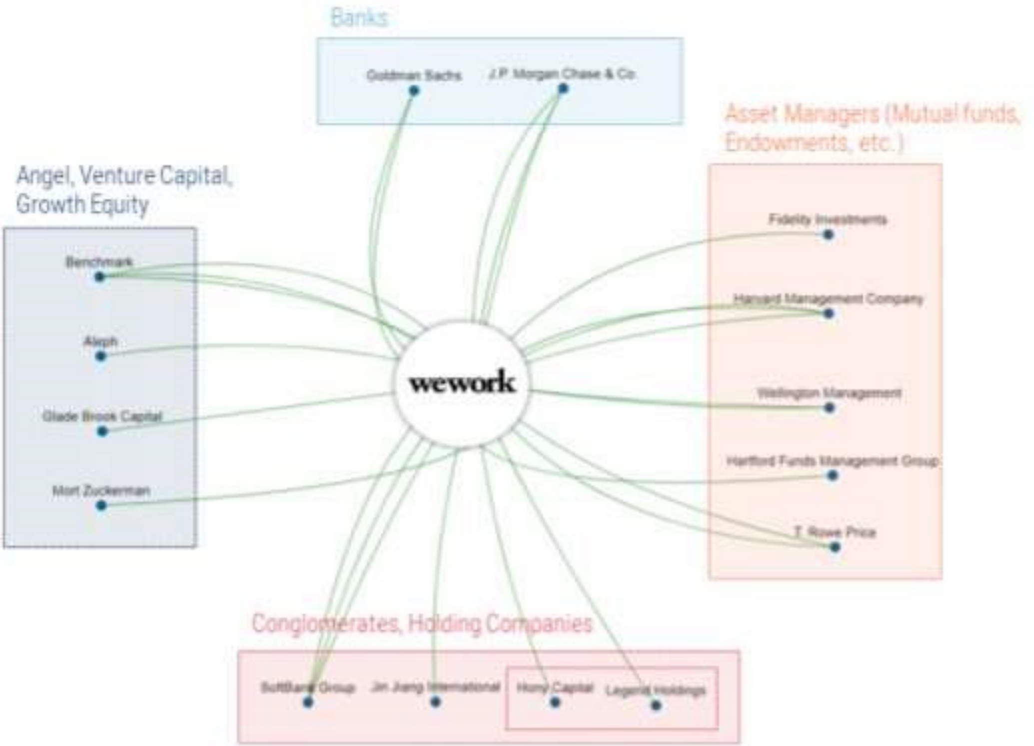
Appendix 1 – Ownership structure

	Beneficial ownership before this offering						Beneficial ownership after this offering						
	Shares of Class A common stock beneficially owned		Shares of Class B common stock beneficially owned		Shares of Class C common stock beneficially owned†‡		Shares of Class A common stock beneficially owned		Shares of Class B common stock beneficially owned		Shares of Class C common stock beneficially owned†‡		Total % of voting power^
	Shares	% of Class	Shares	% of Class	Shares	% of Class	Shares	% of Class	Shares	% of Class	Shares	% of Class	
Greater than 5% stockholders													
WE Holdings LLC(1)	2,428,730		111,848,498		—	—							
Benchmark entities(2)	32,645,314		—		—	—							
J.P. Morgan entities(3)	18,542,307		—		—	—							
Softbank entities(4)	113,988,653		—		—	—							
Directors and named executive officers													
Adam Neumann(1)(5)	2,428,730		112,507,371		943,848	100							
Artie Minson(6)	—	—	1,873,057		—	—							
Jen Berrent(7)	109,933	*	348,792		—	—							
Bruce Dunlevie(2)	32,645,314		—		—	—							
Ron Fisher	—	—	—		—	—							
Lew Frankfort(8)	1,247,033	*	852,309		—	—							
Steven Langman(9)	27,056	*	—		—	—							
Mark Schwartz	—	—	—		—	—							
John Zhao	—	—	—		—	—							
Frances Frei	—	—	—		—	—							
All directors and executive officers, as a group (10 persons)(10)	36,431,010		114,821,543		943,848	100							

(SEC, 2019), Form S-1

https://www.sec.gov/Archives/edgar/data/1533523/000119312519244329/d804478ds1a.htm#toc804478_103

Appendix 2 – Investor composition



(CBINSIGHTS, 2019)

Appendix 3 – Board members

Adam Neumann

- Chairman
- Co-founder and former CEO
- 40 years old Ronald Fisher:
- Since November 2017
- Designated to serve by SoftBank
- Vice Chairman at SoftBank
- 71 years old
- Defined as independent by WeWork

Bruce Dunlevie

- Since July 2012
- Designated to serve by Benchmark
- Owner of Benchmark
- 62 years old
- Defined as independent be WeWork

Steven Langmann

- Since July 2012
- Chairman of WeWork's subsidiary ARK
- Also serves on the management committee at ARK
- Owns 27,000 WeWork shares
- 57 years old

Mark Schwartz

- Since March 2017
- Joined after SoftBank's 4.4b investment
- SoftBank board member until May
- 65 years old
- Defined as independent by WeWork

Lewis Frankfort

- Since July 2014
- Lend 6.3m from WeWork, which he paid back in May
- Owns 2m shares in WeWork
- 73 years old
- Defined as independent by WeWork

John Zao

- Since July 2015
- Designated to serve by Hony Capital
- Founder and CEO of Hony Capital
- 56 years old
- Defined as independent by WeWork

Frances Frei

- Expected to join once IPO is completed
- Been doing HR consulting for WeWork since March
- 56 years old

Sources

- SEC IPO S-1
- SEC IPO amendment no.2

Appendix 4 – Management composition

(CBINSIGHTS, 2019)