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Where Have All the Public Companies Gone?

There are 3,671 domestic listings today, down from 7,322 in 1996. Investors can feel the difference.

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The media and the public pay a lot of attention to broad stock market indexes, but many of the most well-known measures aren't what they seem. The Wilshire 5000, for example, contains roughly 3,500 companies. There haven't been 5,000 domestic stocks to include in the index since 2005.

The number of public companies in the U.S. has been on a steady decline since peaking in the late 1990s. In 1996 there were 7,322 domestic companies listed on U.S. stock exchanges. Today there are only 3,671. Easy access to venture, growth and private-equity capital means that companies no longer need to pursue an initial public offering to fund growth or access liquidity. Increases in regulations, shareholder lawsuits and activist demands have also diminished the appeal of a public listing. Over the past two decades, the number of annual IPOs has fallen sharply, to 128 in 2016 from 845 in 1996.

Companies are going public later in their lifespans—if they ever do at all. The dearth of IPOs has led to a 50% increase in the average age of public companies, from 12 years in 1996 to 18 years in 2016. Jeff Bezos founded Amazon in 1994, taking the company public three years later with an enterprise value of approximately $600 million. From 1997 to 2002 public investors enjoyed a 12-fold appreciation in Amazon's stock. Conversely, Mark Zuckerberg waited until Facebook was eight years old before taking it public. At the time of Facebook's IPO in 2012, the social-media company had a market value of more than $100 billion.

The trend away from IPOs has benefited private market players at the expense of everyday investors. With companies like Uber, Airbnb and other successful startups delaying their IPOs for so long, there is little prospect for public returns on a scale similar to those enjoyed by Amazon's early stockholders. The aversion to public listings isn't limited to the technology sector. Microcap, small-cap and midcap stocks have all but disappeared from U.S. exchanges. Over the past 20 years, the average size of a publicly listed company in the U.S. has risen nearly fourfold, after accounting for inflation.

As a large number of yesterday's "growth stocks" have migrated to private portfolios, so too has the diversifying economic exposure they provide. The dispersion of stock returns—the average difference in monthly returns across all stocks—has declined as a result, narrowing the gap between the winners and losers. Less dispersion reduces the value of stock picking, and investors have responded accordingly. Since 2000, roughly $1.7 trillion has been invested using passive strategies like exchange-traded funds and index mutual funds. At the same time, funds pursuing active strategies have experienced $1.4 trillion in outflows.

Since ETFs and index funds buy stocks on a pro rata basis, ignoring price or fundamentals, the rise of passive investing has intensified the correlation of returns across stocks. Discretionary, research-based stock selection now accounts for only 10% of average trading volume. The offsetting deviations in company performance that were once the hallmark of a broadly diversified stock portfolio have been overwhelmed by marketwide buy or sell orders.

Equity allocations are supposed to offer investors exposure to earnings growth and idiosyncratic business risk. Company-specific outperformance has become increasingly difficult to achieve in public markets dominated by mature businesses and passive fund flows. Today, it isn’t possible to assemble a portfolio with the same makeup as the stock market of 1997 without exposure to private markets.

Many investors take this approach in emerging markets, where mega banks, mining, energy and telecommunications companies tend to account for a disproportionate share of available stocks. The limited pool of investment options in such countries means that market values tend to be highly correlated and fluctuate in response to fund flows rather than fundamentals. The greater the dissonance between the stock market and the real economy, the more investors must rely on various forms of private equity to gain exposure to the underrepresented but faster-growing industry segments and companies.

The stock market today isn’t the stock market of 20 years ago. Investors, take heed.

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