

# Rumours of the Death of the American Public Company are Greatly Exaggerated

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When drafting this essay, the author has drawn heavily on *The Public Company Transformed*, which is currently in press. The research has been supported by funding the Leverhulme Trust has generously provided.

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## Abstract

The public company has historically been a crucial element of the American economy. Various predictions have been made recently that the public company's future is bleak. This essay maintains these gloomy conjectures are erroneous. Companies leave the stock market by way of public-to-private buyouts with some regularity but large firms are rarely affected. Prosperous start-up companies are delaying joining the stock market but nevertheless usually end up in the public domain. There are considerably fewer public companies now than there were twenty years ago. Based, however, on the ratio of aggregate market capitalization to gross domestic product, the public company is currently as important relative to the U.S. economy as it ever have been, if not more so.

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Keywords: public companies, corporate governance, private equity, initial public offerings

JEL Classifications: G34, K22, M13

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# Rumours of the Death of the American Public Company are Greatly Exaggerated

Brian R. Cheffins\*

Forthcoming, *Company Lawyer*

## Abstract

The public company has historically been a crucial element of the American economy. Various predictions have been made recently that the public company's future is bleak. This essay maintains these gloomy conjectures are erroneous. Companies leave the stock market by way of public-to-private buyouts with some regularity but large firms are rarely affected. Prosperous start-up companies are delaying joining the stock market but nevertheless usually end up in the public domain. There are considerably fewer public companies now than there were twenty years ago. Based, however, on the ratio of aggregate market capitalization to gross domestic product, the public company is currently as important relative to the U.S. economy as it ever have been, if not more so.

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## Introduction

The public company has dominated the corporate economy of the United States for decades. Might this era be ending? The *Telegraph* newspaper told readers in 2018 that “the demise of the listed company” was “holding the U.S. back.”<sup>1</sup> Similar predictions about the public company’s dismal future have been made with some frequency. But are the American public company’s days in fact numbered? Well-known author and humourist Mark Twain’s famously responded to an erroneous 1897 newspaper article concerning his passing with the retort that reports of his death were very much an exaggeration.<sup>2</sup> This essay argues the position is much the same with claims about the supposed demise of the American public company. There has been a marked decline in the number of public companies since 2000. Nevertheless, the public company remains a crucial element of the American economy and should continue to do so for the foreseeable future.

This essay describes initially the central role the public company has played in the American corporate realm. Next, evidence indicating that the public company’s dominance is under threat will be canvassed. A description of the primary dangers the public company faces follows, with the focus being on removal of companies from the stock market due to public-to-

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<sup>1</sup> Supriya Menon, “Demise of the Listed Company is Holding the U.S. Back”, *Telegraph*, 28 March 2018, Business, 2.

<sup>2</sup> On what Twain actually said and when, see Joseph W. Campbell, “Noting the Anniversary of Twain’s ‘Report of My Death’ Comment”, *Media Myth Alert*, 1 June 2011, available at <https://mediamythalert.wordpress.com/2011/06/01/noting-the-anniversary-of-twains-report-of-my-death-comment/> (accessed 5 July 2018).

private buyouts by private equity firms and a bias against carrying out initial public offerings (IPOs) recently evident amongst operators of businesses with promising futures. The essay then argues neither trend poses an existential threat to the American public company. The paper concludes by drawing upon history to reinforce the points made.

### **The Importance of the American Public Company**

While publicly traded companies comprise only 4300 of America's 28 million businesses, they are responsible for half of all business capital spending.<sup>3</sup> Public company dominance has existed in the United States for decades. Adolf Berle and Gardiner Means reported that among America's largest 200 non-financial corporations as of 1930, ranked by assets, only 12 lacked an important public interest and one of these was clearly publicly traded with over 12,000 shareholders.<sup>4</sup>

As for today, among the *Fortune* 500, which ranks America's largest firms by annual revenue generated, 470 of the companies comprising the 2017 list had their market value listed, implying they were publicly traded.<sup>5</sup> Total sales generated by companies in the *Fortune* 500 increased from 59% of U.S. gross domestic product (GDP) in 1995 to 65% in 2017.<sup>6</sup> With the

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<sup>3</sup> Jamie Dimon and Warren Buffett, "Short-Termism Is Harming the Economy", *Wall Street Journal*, 7 June 2018, A17.

<sup>4</sup> Adolf A. Berle and Gardiner C. Means, *The Modern Corporation & Private Property* (New York: Harcourt, Brace and World, 1932), 86, 106.

<sup>5</sup> "Largest US Corporations", *Fortune*, 15 June 2017, F1.

<sup>6</sup> Laura Entis, "America: A Growth Industry", *Fortune*, 15 June 2017, 149.

vast majority of *Fortune* 500 companies being publicly traded this statistic was driven primarily by public corporations.

The composition of the *Fortune* 500 exaggerates somewhat the importance of public companies. For corporations which are not listed on the stock market, eligibility for the list is limited to those that file financial documentation with government regulators.<sup>7</sup> Numerous large private companies do not do this. *Forbes* issues annually, however, a list of America's largest private companies ranked by revenue which is not restricted by disclosure practice. This can be drawn upon to obtain a more realistic picture of the public company's economic significance.

Publicly traded Textron was ranked 200<sup>th</sup> in the 2017 *Fortune* 500 with annual revenues of \$13.8 billion.<sup>8</sup> Twenty companies on *Forbes*' 2017 largest private companies list had revenues higher than Textron.<sup>9</sup> Two of those companies (Albertsons and Publix Super Markets) were among the top 200 firms on the *Fortune* 500 list. Among those top 200, there were 10 additional companies, primarily mutually owned insurance companies, that had no market value listed and thus would not have been publicly traded. Combining the data from *Forbes* and *Fortune* while making due allowance for duplication in the case of Albertsons and Publix Super

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<sup>7</sup> Andrea Murphy, "America's Largest Private Companies 2017", *Forbes.com*, 9 August 2017, available at <https://www.forbes.com/sites/andreamurphy/2017/08/09/americas-largest-private-companies-2/#2255a3f5247c> (accessed 21 May 2018).

<sup>8</sup> "Largest US Corporations", n. 5 above.

<sup>9</sup> "America's Largest Private Companies 2017," *Forbes.com*, available at <https://www.forbes.com/largest-private-companies/list/> (accessed 21 May 2018).



Markets indicates that as of 2017 there were 28 private firms among the 200 largest American companies ranked by revenue and 172 that were publicly traded.

The importance of the public company in the American corporate context is not reflected merely in statistics. The United States was the country where in the 1970s debates concerning managerial accountability, board structure and shareholder rights first became channelled through “corporate governance” terminology.<sup>10</sup> Early analysis of corporate governance focused pretty much exclusively on U.S. corporations and more particularly firms with publicly traded shares.<sup>11</sup> Corporate governance began taking on a robust international orientation in the early 1990s and beginning in the early 2000s there was “an explosion of research on corporate governance around the world.”<sup>12</sup> Nevertheless, much empirical analysis continues to be derived from American public company data.<sup>13</sup>

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<sup>10</sup> Brian R. Cheffins, ‘The History of Corporate Governance’ in Mike Wright *et al.*, (eds.), *The Oxford Handbook of Corporate Governance* (Oxford: Oxford University Press), 46, 46-47.

<sup>11</sup> Shann Turnbull, “Corporate Governance: Its Scope, Concerns and Theories”, (1997) 5 *Corporate Governance: An International Review*, 180, 188; Diane K. Denis and John J. McConnell, “International Corporate Governance”, (2003) 38 *Journal of Financial and Quantitative Analysis* 1, 1.

<sup>12</sup> Denis and McConnell, n. 11 above, 2.

<sup>13</sup> Brian K. Boyd, Steve Gove and Angelo M. Solarino, “Methodological Rigor of Corporate Governance Studies: A Review and Recommendations for Future Studies”, (2017) 25 *Corporate Governance: An International Review* 384, 386-87.

## The American Public Company in Peril

The *Telegraph* is by no means alone in forecasting a gloomy future for the American public company. A *Financial Times* columnist suggested in 2014 that in the United States and elsewhere publicly traded companies “are dying off, if not like flies then perhaps more like other things no longer suited to their environment—dinosaurs, say.”<sup>14</sup> The *New York Times* indicated in 2016 that “(p)ublicly listed companies in the United States have become something of a dying breed.”<sup>15</sup> On the academic front, a core claim in management professor Gerald Davis’s 2016 book *The Vanishing American Corporation* was that “the public corporation will no longer be the default way of doing business.”<sup>16</sup> Even public company executives are disillusioned with stock market exposure. When asked in 2015, 84 percent of *Fortune* 500 chief executives said they would find it easier to manage their company if it was private.<sup>17</sup>

A marked decline in the number of publicly traded companies in the United States lends credence to gloomy conjectures about the future of the public company. There was a substantial drop in the public company population from the late 1990s through to the late 2000s and there has not been a meaningful rally in the years since (Figure 1). This occurred despite the overall

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<sup>14</sup> Simon Caulkin, “On Management”, *Financial Times*, 20 October 2014, FT Business Education, 12.

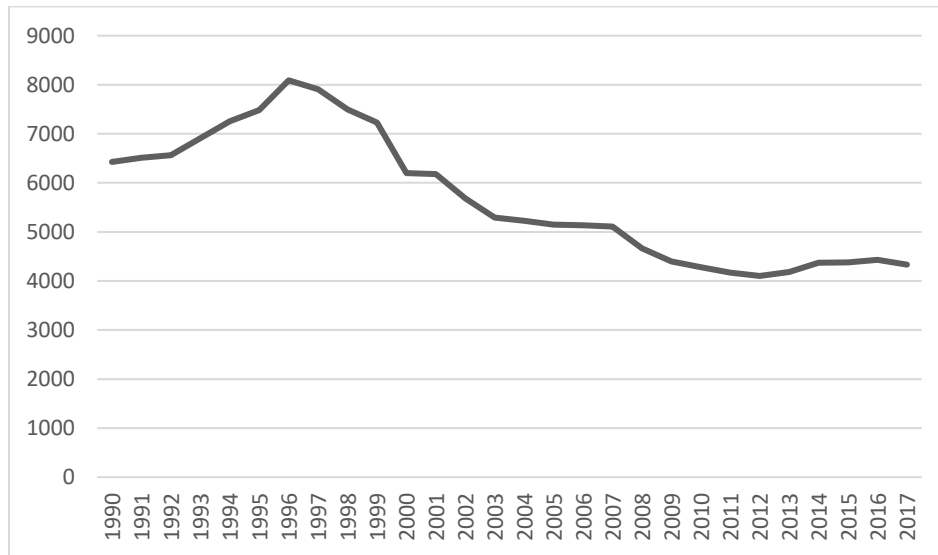
<sup>15</sup> Andrew Ross Sorkin, “Chiefs Meet in Secret to Examine Governance”, *New York Times*, 21 July 2016, B6.

<sup>16</sup> Gerald F. Davis, *The Vanishing American Corporation: Navigating the Hazards of a New Economy* (Oakland: Berrett-Koehler), 9.

<sup>17</sup> Alan Murray, “Myth-Busting the *Fortune* 500”, *Fortune*, 15 June 2015, 14.

number of firms operating in the U.S. increasing from 4.70 million in 1996 to 5.04 million in 2012 and despite the number of companies listed on stock markets outside the U.S. increasing 28 percent over that same period.<sup>18</sup>

Figure 1: Number of Listed Companies, 1990-2017



Source: World Bank (2018)<sup>19</sup>

### Dangers Facing the Public Company

Exit and entry to the stock market dictate how many public companies there will be at any one time. Exits from the stock market can occur due to listed firms being acquired by

<sup>18</sup> Craig Doidge, G. Andrew Karolyi and René M. Stulz, “The U.S. Listing Gap”, (2017) 123 *Journal of Financial Economics* 464, 467, 473.

<sup>19</sup> World Bank, “Listed Domestic Companies, Total”, available at <https://data.worldbank.org/indicator/CM.MKT.LDOM.NO?locations=US> (accessed 15 July 2018).

another corporation, falling afoul of eligibility requirements for listing (typically due to financial distress) and opting to give up public status because it is no longer worthwhile to remain listed.<sup>20</sup> The most dramatic form of exit, however, is a buyout of an otherwise viable public company by a private equity firm. Governance advantages ostensibly associated with such a move imply private equity buyout activity could seriously jeopardize the future of the American public company.

As for entry to the public company universe, the initial public offering is the key mechanism. Since the early 2000s, however, American companies have been reluctant to take this step. Recently, numerous companies valued at \$1 billion or more have become known as “unicorns” because they have been refraining from joining the stock market.

#### *Public to Private Buyouts*

Public-to-private buyouts are executed by funds organized as limited partnerships and run by private equity firms that charge investors fees linked to assets under management.<sup>21</sup> Buyout funds also acquire businesses by purchasing divisions companies are looking to off-load and by way of “secondary” buyouts, which involve acquiring a portfolio company from another private

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<sup>20</sup> Doidge, Karolyi and Stulz, n. 18 above, 475; Kathleen M. Kahle and René M. Stulz, “Is the U.S. Public Corporation in Trouble?”, (2017) 31 *Journal of Economic Perspectives*, 67, 70.

<sup>21</sup> Brian Cheffins and John Armour. “The Eclipse of Private Equity”, (2008) 33 *Delaware Journal of Corporation Law*, 1, 9.

equity firm.<sup>22</sup> By virtue of these various types of buyout activity, the top private equity houses are major employers in the United States, albeit indirectly because it is the limited partnership funds they oversee that actually own the controlling stakes in the businesses in question. The portfolio companies of private equity giants Carlyle and Kohlberg Kravis and Roberts (KKR) each employ collectively over 700,000 workers, with the equivalent figures for their peers Blackstone and Apollo being approximately 600,000 and 300,000 respectively.<sup>23</sup> Each is among the 10 largest employers in the United States.<sup>24</sup>

Conceptually, public-to-private buyouts constitute a particularly potent threat to the public company because of apparent governance advantages relating to monitoring and incentivizing management. American public company executives rarely own more than a tiny percentage of the outstanding equity in the firms they run, which attenuates their drive to create shareholder value.<sup>25</sup> Nevertheless, the institutional investors which dominate share ownership

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<sup>22</sup> Cheffins and Armour, n. 21 above, 9, 14, 21; “Barbarians Grow Up”, *Economist*, 28 July 2018, 53.

<sup>23</sup> “The Barbarian Establishment”, *Economist*, 22 October 2016, 15; Gillian Tett, “Private Equity and Trump’s Quest for Jobs”, *Financial Times*, 5 May 2017, 11.

<sup>24</sup> Tett, n. 23 above.

<sup>25</sup> Kevin J. Murphy, “Executive Compensation: Where We Are, and How We Got There” in George M Constantinides, Milton Harris and René Stulz (eds.), *Handbook of the Economics of Finance*, vol. 2, (Amsterdam: North Holland), 211, 233-35.

typically refrain from active engagement with management.<sup>26</sup> In contrast, because private equity buyout funds own a majority of the shares of companies acquired, the private equity firms in charge should be suitably motivated and sufficiently powerful to orchestrate change at any hint of things going awry.<sup>27</sup> Moreover, with companies owned by private equity funds the executives in charge are typically bestowed with a substantial ownership interest that provides a direct financial incentive to focus closely on the bottom line lacking with most public companies.<sup>28</sup>

Boards have also been cited as a private equity strength.<sup>29</sup> While the fact that independent directors dominate public company boards numerically in the U.S. theoretically improves the potential for effective monitoring of management, with these directors being part-timers there is a danger they will be counterproductively detached from the companies they serve.<sup>30</sup> In contrast, with a business operating under the private equity umbrella, the outside directors will typically be representatives of the private equity firm that orchestrated the buyout.

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<sup>26</sup> Brian R. Cheffins, “Introduction”, in Brian R. Cheffins, ed., *The History of Modern U.S. Corporate Governance* (Cheltenham: Edward Elgar, 2011), ix, x, xix-xx, xxviii.

<sup>27</sup> Cheffins and Armour, n. 21 above, 9, 12-14.

<sup>28</sup> Cheffins and Armour, n. 21 above, 12-13.

<sup>29</sup> Steven N. Kaplan and Per Strömberg, “Leveraged Buyouts and Private Equity”, (2009) *23 Journal of Economic Perspectives* 121, 131-32.

<sup>30</sup> Cheffins, n. 26 above, xv, xxix; Ronald J. Gilson and Charles K. Whitehead, “Deconstructing Equity: Public Ownership, Agency Costs; and Complete Capital Markets”, (2008) *108 Columbia Law Review* 231, 236, 259-60.

Those directors, mindful that a sale of a portfolio company at an advantageous price can substantially boost the value of a buyout fund, should be eager to get their corporation in shape to sell at an advantageous price. They correspondingly should be more likely to provide beneficial strategic leadership and attentive supervision than their counterparts in a public company.<sup>31</sup>

### *Avoiding the Stock Market*

Current speculation regarding the gloomy future of the public company revolves around sizeable firms shying away from going public more than private equity firms removing companies from public markets. With exits occurring in various ways, if firms with promising prospects balk at joining the stock market a dwindling pool of public companies may never be replenished.<sup>32</sup> The long-term future for the public company would then necessarily be gloomy.

What is referred to as the “unicorn” phenomenon exemplifies the current reticence to join the stock market. It was unknown before the 2008 financial crisis for an American start-up

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<sup>31</sup> Ronald W. Masulis and Randall S. Thomas, “Does Private Equity Create Wealth? The Effects of Private Equity and Derivatives on Corporate Governance”, (2009) 76 *University of Chicago Law Review* 219, 224, 228, 258.

<sup>32</sup> Alexander Ljungqvist, Lars Persson and Joacim Tåg, “Private Equity’s Unintended Dark Side: On the Economic Consequences of Excessive Delistings”, (2016) NBER Working Paper 21909, 7.

company to achieve a valuation greater than \$1 billion without carrying out an IPO.<sup>33</sup> When this first began to occur “unicorn” became the term of art used to describe such firms so as to symbolize their rarity.<sup>34</sup> The private company unicorn has since flourished. As of 2018, 105 still private U.S. start-ups were valued at \$1 billion or more, with the number having more than tripled in four years.<sup>35</sup>

The unicorn phenomenon has developed in a wider context where IPO activity, or more accurately a lack thereof, has become a source of concern. The chair of the Securities and Exchange Commission acknowledged in 2011 IPO activity “was not as robust...as we would like it to be.”<sup>36</sup> In 2017, the *Wall Street Journal* drew attention to “concern that the public markets are being used as a last resort.”<sup>37</sup> Worries have arisen primarily because the number of companies going public in the U.S. has failed to rally substantially after an abrupt decline following the end of a “dot.com” IPO frenzy at the beginning of the 2000s (Figure 2).

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<sup>33</sup> Jennifer S. Fan, “Regulating Unicorns: Disclosure and the New Private Economy”, (2016) *57 Boston College Law Review* 583, 583.

<sup>34</sup> Fan, n. 33 above, 586.

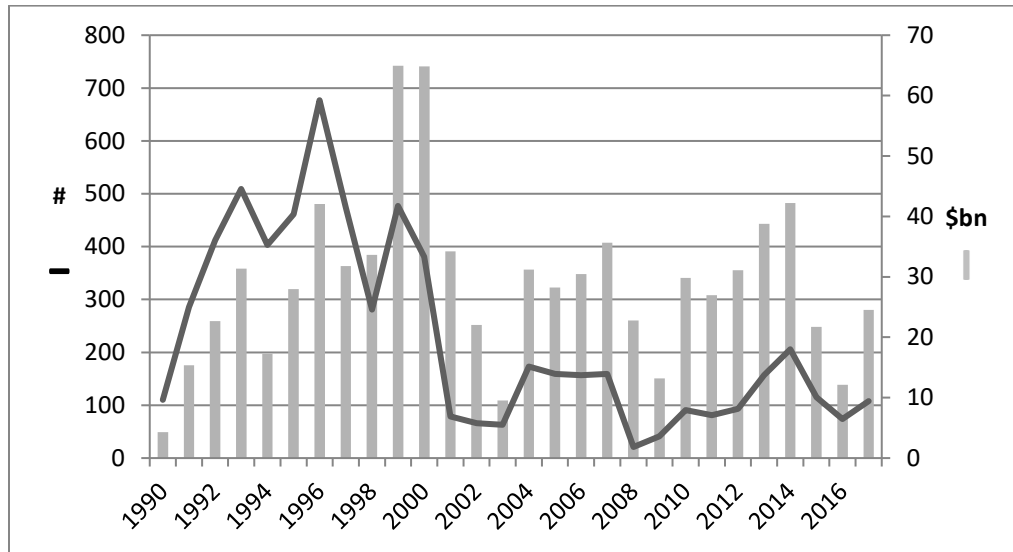
<sup>35</sup> Jean Eaglesham and Coulter Jones, “Powering U.S. Business: Private Capital”, *Wall Street Journal*, 3 April 2018, A1.

<sup>36</sup> Aaron Lucchetti, “U.S. Falls Behind in Stock Listings”, *Wall Street Journal*, 26 May 2011, A1.

<sup>37</sup> Corrie Driebusch & Maureen Farrell, “Market Fuels an IPO Push but Biggest Names Hold Off”, *Wall Street Journal*, 8 May 2017, A1.



Figure 2: Number of U.S. IPOs and Aggregate Proceeds, 1990-2017



Source: Ritter (2018): 3<sup>38</sup>

Lukewarm investor interest has helped to suppress IPO activity. During the dot.com boom there was a voracious appetite for tech-related IPOs among retail investors.<sup>39</sup> In contrast, today’s investors “are not in there flipping IPOs. The individual investor participation, which tends to be the easy money, is not there, and it’s very unlikely to come back”.<sup>40</sup>

Reluctant sellers have dampened IPO activity as much, if not more than, discerning buyers. “The initial public offering of stock has become déclassé”, with “many founders

<sup>38</sup> Jay R. Ritter, “Initial Public Offerings: Updated Statistics”, January 17, 2018, available at [https://site.warrington.ufl.edu/ritter/files/2018/01/IPOs2017Statistics\\_January17\\_2018.pdf](https://site.warrington.ufl.edu/ritter/files/2018/01/IPOs2017Statistics_January17_2018.pdf) (accessed 15 June 2018).

<sup>39</sup> “To Fly, to Fall, to Fly Again”, *Economist*, 25 July 2017, 17.

<sup>40</sup> Alexander Eule, “The Disappearing IPO Market”, *Barron’s*, 6 June 2016, 23.

talk(ing) about going public as a necessary evil to be postponed as long as possible because it comes with more problems than benefits.”<sup>41</sup> With respect to “problems” associated with IPOs, excessive regulation associated with the process is often cited as a significant deterrent to a move to the stock market.<sup>42</sup> It is doubtful, however, whether regulation has played a major role in dissuading firms from going public. The Jumpstart Our Business Startups (JOBS) Act, enacted by Congress in 2012, deregulated IPO mechanics in various respects.<sup>43</sup> The number of IPOs carried out annually in the years since has nevertheless remained well below pre-2001 levels (Figure 2). Correspondingly, whatever boost deregulation has provided to IPO activity,<sup>44</sup> it has been very modest.

The reticence regarding IPOs has in fact been due primarily to market factors. If a privately held company with promising prospects is producing relatively little cash flow, for the proprietors the possibility of raising capital by selling shares to the public can provide a

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<sup>41</sup> Farhad Manjoo, ‘The Next Big Tech IPO Could Be a Private One’, *New York Times*, 2 July 2015, B1.

<sup>42</sup> Xiaohui Gao, Jay R. Ritter & Zhongyan Zhu, “Where Have All the IPOs Gone?”, (2013) 48 *Journal of Financial and Quantitative Analysis* 1663, 1663-64.

<sup>43</sup> Carlos Berdejo, “Going Public after the JOBS Act”, (2015) 76 *Ohio State Law Journal*, 1, 22-27.

<sup>44</sup> For a study offering such a finding, see Michael Dambra, Laura Casares Field and Matthew T. Gustafson, ‘The JOBS Act and IPO Volume: Evidence That Disclosure Costs Affect the IPO Decision’, (2015) 116 *Journal of Financial Economics* 121.

compelling reason to join the stock market. A desire to provide liquidity for current shareholders can do the same.<sup>45</sup> While shares in a private company can be difficult to sell, with a stock market listing investors seeking to diversify or cash out fully can typically count on being able to exit promptly at or near the prevailing market price. Still, while theoretically capital raising and liquidity concerns can foster IPOs, in recent years market trends have weakened these incentives to go public.

With respect to liquidity, for shareholders of successful companies that have not gone public exiting is easier than used to be the case. Private equity funds, sovereign wealth funds and even some publicly traded firms have stepped forward to buy up sizeable stakes of private companies that have come up for sale.<sup>46</sup> With smaller holdings, NASDAQ has taken the initiative. It launched in 2014 an online marketplace to match buyers and sellers of shares in private companies and the following year acquired rival SecondMarket, which had been operating a similar trading platform since 2009.<sup>47</sup>

As for a move to the stock market to assist with financing, it is now possible for promising ventures to scale up more cheaply than used to be the case. With the American

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<sup>45</sup> Brian R. Cheffins, *Corporate Ownership and Control: British Business Transformed*, (Oxford: Oxford University Press, 2008), 65-66, 72.

<sup>46</sup> Eliot Brown & Greg Bensinger, "Firms Buy Stakes of Startups Privately", *Wall Street Journal*, 20 November 2017, B1.

<sup>47</sup> Tess Stynes & Bradley Hope, "Nasdaq Buys SecondMarket", *Wall Street Journal*, 23 October 2015, C3.

economy having become increasingly technology-intensive there is a reduced need to spend on costly fixed assets such as plants and equipment.<sup>48</sup> Moreover, innovations such as outsourced “cloud” infrastructure, e-mail, open-source software and social media mean start-up ventures can access readily and inexpensively computing and communication capabilities formerly restricted to large corporations.<sup>49</sup>

Growing companies not only require less capital than they used to but they also can get what they need more readily without a public offering of shares. Web-based financing interfaces have made it easier for those running fledgling ventures to link up with affluent “angels” looking to back promising start-ups with seed capital.<sup>50</sup> The venture capital industry in the U.S. has

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<sup>48</sup> Michael J. Mauboussin, Dan Callahan & Darius Majid, “The Incredible Shrinking Universe of Stocks: The Causes and Consequences of Fewer US Equities”, *Credit Suisse: Global Financial Strategies*, 22 March 2017, 2, 12; Craig Doidge, *et al.* “Eclipse of the Public Corporation or Eclipse of the Public Markets?”, (2018) ECGI Working Paper in Finance, No. 547/2018, 13.

<sup>49</sup> Keith C. Brown & Kenneth W. Wiles, “In Search of Unicorns: Private IPOs and the Changing Markets for Private Equity Investments and Corporate Control”, (2015) 27(3) *Journal of Applied Corporate Finance* 34, 45.

<sup>50</sup> Stephen Foley, “Flurry of Innovation Prompts Easier Access to Funding”, *Financial Times*, 9 February 2016, Raising Capital, 2.

grown substantially over the past dozen years,<sup>51</sup> thereby improving an entrepreneur’s chances of obtaining funding from this source. Mutual funds and sovereign wealth funds have joined venture capitalists in participating in later stage financing of promising privately held enterprises.<sup>52</sup> Mid-1990s deregulation fostered the conduct of capital-raising of this sort by making it easier for companies prepared to focus exclusively on investors with credentials as “qualified purchasers” to issue securities and remain private.<sup>53</sup>

### **Why Reports of the Death of the Public Company are Exaggerated**

If major American public companies were being taken private with a high degree of regularity and prosperous start-ups were avoiding the stock market completely, the future of the American public company would indeed be bleak. In fact, public-to-private buyouts do not pose any sort of existential threat to the dominance of the public company. As for prosperous start-ups, they most often do end up linked to the stock market, albeit quite often through the indirect route of being acquired by a company that is already publicly traded. A by-product is that, while

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<sup>51</sup> National Venture Capital Association, *2018 Yearbook*, (NVCA, 2018), 10, available at <https://nvca.org/research/research-resources/> (accessed 18 June 2018).

<sup>52</sup> Renee Jones, “The Unicorn Governance Trap”, (2017) 166 *University of Pennsylvania Law Review Online* 165, 173.

<sup>53</sup> Michael Ewens and Joan Farre-Mensa, “The Deregulation of the Private Equity Markets and the Decline in IPOs” (2018), unpublished working paper, available at <https://papers.ssrn.com/abstract=3017610>, discussing National Securities Markets Improvement Act of 1996, Pub. L. 104-290.

there are fewer public companies than there used to be, those which are listed on the stock market are larger than they were formerly. That in turn means that the public company remains as crucial a feature of the American economy as it has ever been.

*Public-to-Private Buyouts*

The firms which launch buyout funds to carry out public-to-private transactions were first referred to regularly as private equity firms in the late 1990s.<sup>54</sup> The execution of going private transactions by buyout funds has been occurring in the U.S., however, since the end of the 1970s.<sup>55</sup> Predictions that public-to-private buyouts would sound the death knell for the public company extend back nearly as far. Such predictions have proved to be incorrect, and the prognosis remains unchanged today.

Financial economist Michael Jensen proclaimed in 1989 in the *Harvard Business Review* “The Eclipse of the Public Corporation”.<sup>56</sup> Jensen argued the public-to-private buyout would deliver the hammer blow to the public company, citing governance advantages such as the stock ownership incentives of executives running companies taken private and the monitoring capabilities of what are now known as private equity firms. Jensen was also impressed by the fact public-to-private buyouts were acquisitions underwritten by substantial borrowing. The

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<sup>54</sup> Cheffins and Armour, n. 21 above, 21.

<sup>55</sup> Cheffins and Armour, n. 21 above, 18.

<sup>56</sup> Michael C. Jensen, “The Eclipse of the Public Corporation”, (1989) 67(5) *Harvard Business Review* 61.

discipline associated with servicing the heavy debt load would, he argued, beneficially curtail managerial discretion.

Jensen's eclipse prediction received substantial coverage in the business media.<sup>57</sup> The timing, however, was unfortunate. "Leveraged" buyout (LBO) activity essentially ceased as the 1990s got underway.<sup>58</sup> LBOs then remained a rarity throughout much of the rest of the decade.<sup>59</sup> Correspondingly, the mechanism Jensen identified as the catalyst for the public company's demise was at least temporarily in abeyance.

The public-to-private transaction returned with a vengeance in the mid-2000s. Between 2004 and 2007, public-to-private buyouts worth \$535 billion were completed as compared with \$50 billion between 1996 and 2003 (in 2007 dollars) and \$227 billion between 1986 and 1989 (again in 2007 dollars).<sup>60</sup> Nine of the ten largest U.S.-based public-to-private buyouts ever

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<sup>57</sup> See, for example, George Melloan, "Reading the Tea Leaves on Corporate Privatizations", *Wall Street Journal*, Sept. 19, 1989, A31; Christopher Farrell, "The LBO Isn't a Superior New Species", *Business Week*, Oct. 23, 1989, 126.

<sup>58</sup> Shourun Guo, Edith S. Hotchkiss and Weihong Song, "Do Buyouts Still Create Value?", (2011) 96 *Journal of Finance* 479, 479.

<sup>59</sup> Roy C. Smith and Ingo Walter, *Governing the Modern Corporation: Capital Markets, Corporate Control, and Economic Performance* (New York: Oxford University Press, 2006), 34, Table 2.4.

<sup>60</sup> Anil Shivdasani and Yihui Wang, "Did Structured Credit Fuel the LBO Boom?", (2011) 66 *Journal of Finance* 1291, 1291.

would be announced, each with a value exceeding \$22 billion.<sup>61</sup> The dramatic increase in public-to-private buyout activity fostered much speculation that private equity was threatening the public company's dominance.<sup>62</sup> The mid-2000s predictions of the public company's demise based on LBO activity were no more accurate, however, than Jensen's bold 1989 claim. A "credit crunch" in 2007 and the market havoc associated with the 2008 financial crisis abruptly ended the LBO frenzy.<sup>63</sup>

There was something of a private equity rally once the market turmoil abated. In the U.S., the number of public company delistings occurring as a result of a public-to-private buyout has been higher in the 2010s than in any decade other than the 2000s.<sup>64</sup> The public-to-private buyout has not returned, however, to the spotlight mid-2000s style. Leading private equity firms have in fact been diversifying away from buyout transactions. Sometimes styled now as "alternative asset managers", they have developed significant international operations and now provide mergers and acquisition (M&A) advice, underwrite securities issues and manage funds dedicated to business lending, infrastructure projects and property investments.<sup>65</sup> By 2013, only

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<sup>61</sup> Steven M. Davidoff, *Gods at War: Shotgun Takeovers, Government by Deal, and the Private Equity Implosion* (Hoboken, N.J.: John Wiley & Sons, 2009), 35.

<sup>62</sup> Davidoff, above n. 61, 35.

<sup>63</sup> Andrew F. Tuch, "The Remaking of Wall Street", (2017) 7 *Harvard Business Law Review* 315, 339-40.

<sup>64</sup> Mauboussin, Callahan & Majid, n. 48 above, 7, exhibit #5.

<sup>65</sup> Tuch, n. 63 above, 340-47.



a third of the investor assets Apollo managed were tied to corporate buyouts and at Blackstone the share was below 25%, down from 75% a decade previously.<sup>66</sup> Within a couple of years, less than half of assets of Carlyle and KKR would be so allocated.<sup>67</sup>

With public-to-private transactions that continue to occur in the U.S., this has been happening largely under the radar. For instance, deals worth more than \$10 billion have been virtually unknown.<sup>68</sup> \$10 billion may sound like a large number, but as of mid-2018, the market capitalization of the 100<sup>th</sup> ranked company in the S&P 500 stock market index was \$32.1 billion.<sup>69</sup> Private equity in turn is now an afterthought amongst America's largest corporations. Of the 20 private companies with revenue exceeding the 2017 *Fortune* 500's 200<sup>th</sup> ranked company only Albertsons, a grocery retailer that also placed 49<sup>th</sup> in the *Fortune* 500, was under private equity control.<sup>70</sup> Hence, while public-to-private buyouts continue to occur, they are not currently transforming the face of American corporate capitalism in the way Jensen predicted in 1989 and various observers suggested in the mid-2000s. The pattern cannot realistically change

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<sup>66</sup> Ryan Dezember and Nicholas Barivo, "Private-Equity Firms Build Instead of Buy", *Wall Street Journal*, 15 May 2013, A1.

<sup>67</sup> "Barbarian Establishment", n. 23 above.

<sup>68</sup> Paul J. Davies, "Cash Is Piling Up at Buyout Funds", *Wall Street Journal*, 28 August 2017, B11.

<sup>69</sup> S&P Dow Jones Indices, "Equity S&P 100", 29 June 2018, available at <https://us.spindices.com/indices/equity/sp-100> (accessed 20 July 2018).

<sup>70</sup> "Largest US Corporations", n. 5 above, "America's Largest", n. 9 above.

until mid-2000s-style buyout activity returns and becomes a permanent feature of the M&A ecosystem. There is no indication at present that this will occur any time soon.

*Companies Are Not Staying Private Forever*

The reticence of those operating rapidly growing private companies to go public and the associated rise of unicorns have put downward pressure on the number of public companies. Nevertheless, the economic significance of the public company has not been fundamentally compromised. For owners of promising start-up ventures a trade sale, likely to a large established company, has since 2000 grown considerably in popularity in relation to IPOs as an “exit” mechanism.<sup>71</sup> Again, most large American companies are publicly traded. Correspondingly, when promising start-ups sidestep IPOs by selling out to major established businesses the assets most often end up in the public company realm, albeit by a different route. Apple, Alphabet (the parent company of the Google search engine), Amazon, Facebook, and Microsoft, each a publicly traded tech giant, bought up nearly 330 small firms between them between 2013 and 2018.<sup>72</sup>

With a prosperous start-up, if a sale to an established company is not forthcoming, regardless of misgivings among the proprietors about going public a combination of the financial and liquidity factors that prompt IPOs will likely tip the balance over time in favour of a public offering. While exit options for shareholders in private companies have improved, the stock market remains the most convenient venue for selling shares. As for raising cash, even the best-resourced unicorn is unlikely to have the financial wherewithal to carry out large scale

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<sup>71</sup> Gao, Ritter, and Zhu, n. 42 above, 1672.

<sup>72</sup> “Chicago Bears”, *Economist*, 28 April 2018, 62.

acquisitions.<sup>73</sup> Publicly traded equity will be needed either to raise cash to pay the shareholders of targeted companies or to execute share-for-share exchanges with those shareholders.

With IPOs having “become déclassé” but not defunct those companies which join the stock market now do so later than they did formerly. The median age of companies going public on American stock markets is 50 percent higher now than it was 20 years ago.<sup>74</sup> In a related fashion, companies moving to the stock market are bigger than used to be the case. This is evidenced by the fact that the decline in annual aggregate IPO proceeds since 2000 has been much less precipitous than the decline in the number of IPOs (Figure 2). The upshot is that “(p)eople have been staying private for longer, not forever”.<sup>75</sup> Until “forever” becomes the choice, trends relating to IPOs and unicorns will not foretell the demise of the public company.

### **Continued Significance of the Stock Market**

One might infer from the foregoing account of IPOs and unicorns that the decline of the American public company is less precipitous than is widely perceived but is occurring nevertheless. A revised assessment of this nature is closer to the mark but still implies an ultimately dismal outlook for the public company. In fact, public companies arguably are currently as important relative to the U.S. economy as they ever have been, if not more so. The relationship can be measured by reference to the ratio of the aggregate market capitalization of

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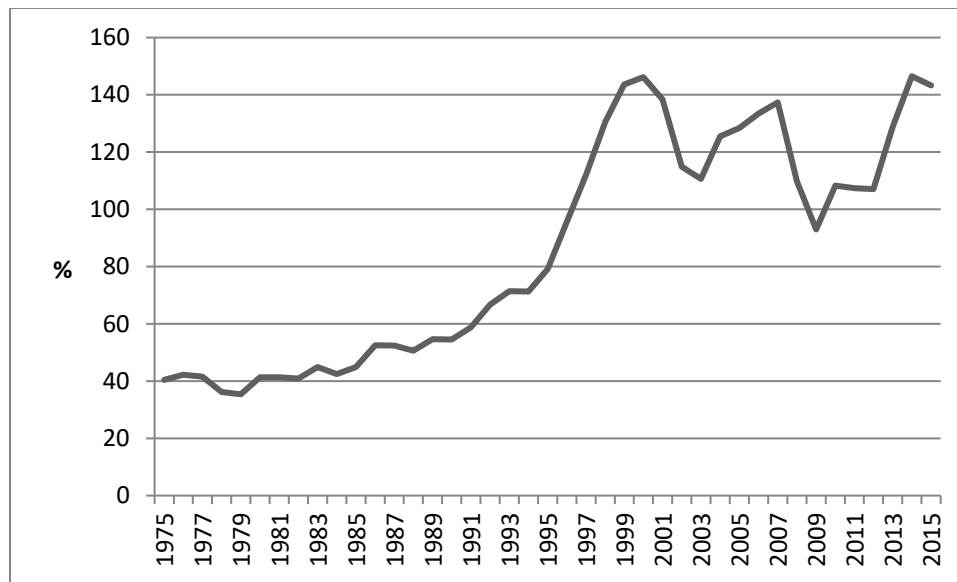
<sup>73</sup> Tom Braithwaite, “Private Pressures”, *Financial Times*, 24 October 2016, 9.

<sup>74</sup> Mauboussin, Callahan & Majid, n. 48 above, 11.

<sup>75</sup> Nicole Bullock and Robin Wigglesworth, “U.S. Seeks Depth in the Listings Pool”, *Financial Times*, 9 January 2018, 9.

publicly traded stocks to Gross Domestic Product (GDP). Due to a stock market rally that began following the 2008 financial crisis, by 2015 the ratio was close to previous all-time highs (Figure 3). With stock prices having increased markedly since then, the stock market has probably never been bigger in relation to the American economy than it is now.

Figure 3: Stock Market Capitalization/GDP, Percent, 1975-2015



Source: Federal Reserve Bank of St. Louis (2017)<sup>76</sup>

Again, the number of public companies has declined. How can this be squared with the growth in aggregate market capitalization? The answer is simple -- those companies which are publicly traded are now considerably bigger. In 2017 the market capitalization of listed U.S. companies averaged almost \$7 billion, more than 10 times as much on an inflation-adjusted basis

<sup>76</sup> Federal Reserve Bank of St. Louis, “FRED Economic Data -- Stock Market Capitalization to GDP for United States, Percent, Annual”, 30 August 2017, available at <https://fred.stlouisfed.org/series/DDDM01USA156NWDB> (accessed 15 June 2018).

as the equivalent figure for 1976.<sup>77</sup> With fewer companies being public, and with those going public joining the stock market later, public investors have less scope to capture the upside with fledgling companies experiencing rapid initial growth and to gain exposure to fast-growing industry segments.<sup>78</sup> Nevertheless, the public company continues to dominate the big business landscape in the U.S. and current trends suggest the pattern should endure.

## Conclusion

Forecasts of the forthcoming extinction of the American public company are by no means novel. We have already seen that predictions to this effect have been made since the 1980s. In fact, the pattern extends back to the 1970s. In a 1979 cover story *Business Week* cited dismal stock market returns and high inflation when proclaiming “the U.S. economy probably has to regard the death of equities as a near-permanent condition -- reversible some day, but not soon.”<sup>79</sup> In a letter to *Business Week*’s editor offering counter-arguments to the magazine’s “death of equities” claim two Goldman Sachs bankers drew an analogy to Twain and his response to the erroneous reports of his demise.<sup>80</sup> Subsequent events proved them correct. The

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<sup>77</sup> Mauboussin, Callahan & Majid, n. 48 above, 8; Doidge *et al.*, n. 48 above, 4-5.

<sup>78</sup> Scott Powell, “A Pox on SOX, It’s Bad for Stocks”, *Wall Street Journal*, 14 February 2018, p. A19.

<sup>79</sup> “The Death of Equities”, *Business Week*, 13 August 1979, 54.

<sup>80</sup> “Readers React to ‘The Death of Equities’”, *Business Week*, 3 September 1979, 68.

1980s would be one of the most favourable decades in the 20<sup>th</sup> century for investors in American public companies.<sup>81</sup>

It seems unlikely that recent predictions of the forthcoming demise of the public company are likely to be any more accurate than *Business Week*'s 1979 prediction or subsequent public company death knell forecasts. Most of America's largest corporations remain publicly traded and the stock market is as large relative to the American economy as it ever has been. The public-to-private buyout, identified as a potent threat to the viability of the public company in the late 1980s and the mid-2000s, remains relevant but does not currently imperil seriously the stock market status of larger public companies. Business enterprises are not going public as frequently as they used to. Nevertheless, the point has not been reached where successful sizeable American firms consistently stay private permanently. Many will enter public markets indirectly as a result of being acquired by a major public corporation. Otherwise, in a case of late as opposed to never, an IPO will ultimately be the likely outcome.

There could be for the publicly traded corporation an unforeseen economic or regulatory equivalent of the asteroid that left behind the Chicxulub crater off Mexico and was ground zero of the Cretaceous period extinction event. Absent such a cataclysm, the American public company does not appear to be a dinosaur destined for oblivion or even obscurity. Instead, in all likelihood the publicly traded corporation will continue to be a pivotal feature of the American economy for some time to come.

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<sup>81</sup> Barry A. Wigmore, *Securities Markets in the 1980s, Volume 1: The New Regime* (New York: Oxford University Press, 1997), 3-4.

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