The shrinking public markets and why this matters

Helen Steers highlights the trend in the declining number of publicly-listed companies, and discusses the key drivers of this phenomenon and the implications for investors

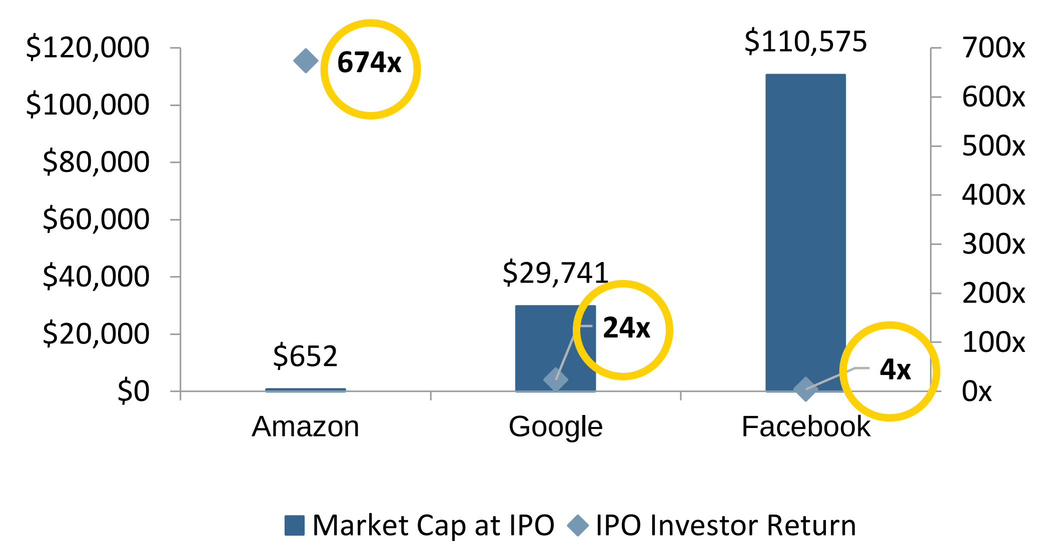
The number of publicly-listed companies across global markets has fallen dramatically in the past 20 years. The UK is no exception, where the number of listed stocks has declined by 26 per cent since 1996. In fact, if you delve deeper and exclude the AIM market, which expanded significantly in the early 2000s, the main UK market has seen a 57 per cent fall[1]. In the US, the number of listed stocks has halved over the same time period[2]. The remaining companies are generally older, slower growing and concentrated in a sub-set of sectors. As a result we believe private equity has become increasingly important to complement a public equities portfolio and to enable investors to reach a broader investment universe.

The first clear driver of this trend is the significant decline in IPO activity. The number of IPOs on the UK main market has fallen by 80 per cent since the turn of the century[3], in part because the traditional benefits of listing, to access capital required to finance growth initiatives and expansion, in many instances no longer outweigh the costs and the increased regulatory burdens. This has reduced the refresh rate of new businesses entering the public market. For instance in the US the average public company is 50 per cent older and ~4x larger than it was 20 years ago. Over the same period, the number of companies in the S&P 500 growing at 20 per cent or greater has halved (from 20 per cent to 10 per cent)[4].

Increasing access to private market capital has had a profound effect, too. Total private equity assets under management (unrealised value and dry powder) now hover at around $2.5 trillion. In 2000 it was just $578 billion.[2]

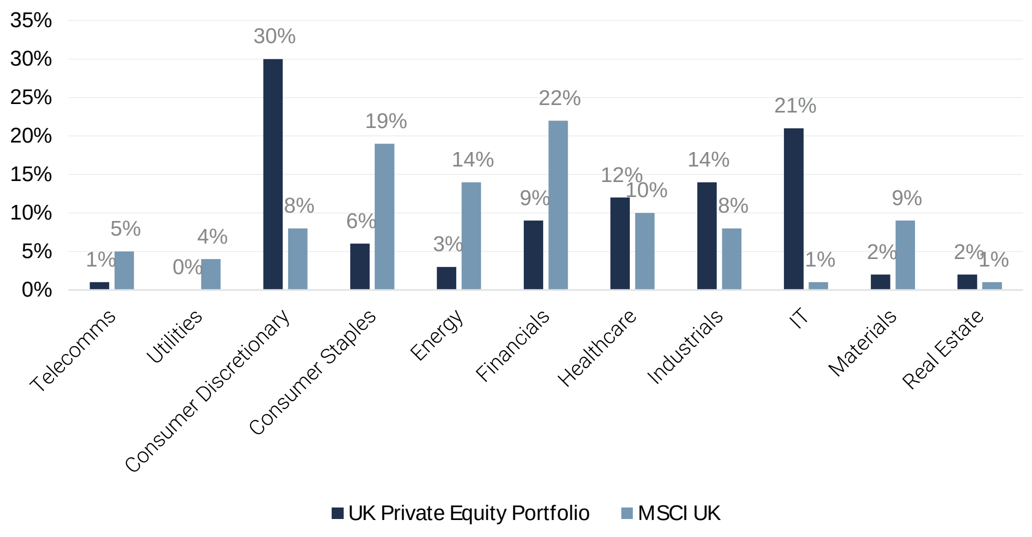
So, whilst traditionally public markets were the only source of capital at scale, today that is not the case. For instance, in 1996 the median amount raised prior to IPO in the US was just $12 million[6]. That figure has grown at 11 per cent per annum to nearly $100 million in 2016, easily within the range of capital that public markets would traditionally provide[7]. We believe that access to private funding allows companies to continue pursuing their growth and business objectives without enduring the costs and distractions associated with operating in the public spotlight.

Figure 1: IPO Investor Returns



Mauboussin, Michael J., Dan Callahan, CFA, and Darius Majd. The Incredible Shrinking Universe of Stocks: The Causes and Consequences of Fewer U.S. Equities. Report. Global Financial Strategies, Credit Suisse. March 22, 2017

Figure 2: Comparative Sector Weightings of Private Equity and Public Market Portfolios



Source for UK Private Equity Portfolio is Pantheon's European portfolio invested capital in UK companies by sector calculated from proprietary database observations of underlying primary investments in PEURO I-VII; MSCI UK sector weightings as disclosed in the 31 August, 2017 index factsheet

More than ever before the rapid growth companies experience, and the value for investors created by that growth, is occurring before IPO. Private equity investors are, in our view, clear beneficiaries.

Three very well-known US companies, Amazon, Google and Facebook highlight the impact that time to IPO and market cap at IPO can have on potential for subsequent growth, and the evolution over time, as shown in Figure 1. As these companies sequentially remained private for longer, by the time of IPO they had achieved greater scale both by revenue and market cap, and we believe the impact on revenue growth and potential for returns is apparent.

There are similar cases of European companies staying private for longer and generating rapid growth pre-IPO. Examples include food delivery service, Just Eat, which listed in 2014, 13 years after it was founded; Games developer, King.com, which took 11 years to go public also in 2014; and Skyscanner, which was founded 14 years before it was sold to a strategic buyer in 2016. All these companies generated very strong returns for their private equity backers.

Private equity can also provide balance to a portfolio both in terms of company size and industry sector, as shown in Figure 2. Eighty-seven per cent of the UK public market value is concentrated in companies with market caps of more than €2 billion. The contrast with Pantheon's private equity portfolio is stark. Eighty-nine per cent of the cost in UK companies in Pantheon's portfolio is in equity investments with enterprise values below €1 billion and 67 per cent below €250 million. Additionally, the UK public market has a bias towards financials (22 per cent), consumer staples (19 per cent) and energy (14 per cent)[8]. Pantheon's UK private equity portfolio includes 21 per cent in IT and 30 per cent in consumer discretionary, both generally faster-growing sectors. The UK public market has just 1 per cent in IT.

The widening gap in sector and company size between the public and private markets suggests that the optimal portfolio provides exposure to both markets.

The Shrinking Public Market and Why it Matters was published by Pantheon in June 2017 and is available at www.pantheon.com

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[1] London Stock Exchange, Market Factsheets pre-2005 and 2005-2016, accessed 25th September 2017.
[2] Doidge, Craig, G. Andrew Karolyi, and René M. Stulz. "The U.S. listing gap." Journal of Financial Economics 123, no. 3 (2017): 464-87. doi:10.1016/j.jfineco.2016.12.002.
[3] London Stock Exchange, New Issues and IPO Summary, accessed 25th September 2017.
[4] S&P CapitalIQ data accessed 31st March 2017
[5] 2017 Preqin Global Private Equity & Venture Capital Report.
[6] WilmerHale 2016 IPO Report.
[7] "Rebuilding the IPO On-Ramp: Putting Emerging Growth Economies and the Job Market Back on the Road to Growth." Issue brief. IPO Task Force. 20th October 2011.; WilmerHale 2016 IPO Report
[8] MSCI UK sector weightings as disclosed in the 31st August 2017 index factsheet