Honey, I shrunk the listings

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The shrinking number of companies listed in developed markets is raising concerns in some quarters of the investment industry. The statistics are striking. In the US, there has been a 40% drop in the number of listed companies since 1996. The numbers are even more acute in the UK, which has seen a 60% reduction over the same period, and a staggering 75% drop since the 1960s[1].

Institutional investor allocations to private equity have grown from 6.4% in 2014 to 10.1% at the end of 2023[2], a significant increase in available capital for private businesses, denting the public market's status as the best route to raise capital by virtue of its much higher levels of liquidity. However, there appears to be several reasons other than the greater availability of private capital to motivate a business to choose to stay private.

Firstly, the reporting burden of a public business has become more onerous over the decades, with the time and cost associated with maintaining a listing and meeting reporting requirements, deemed unworthy of the benefits by many company management teams. The Quoted Companies Alliance, a not-for-profit organisation representing small and mid-sized publicly traded companies in the UK, found that the average word count of a listed UK company's annual reports had grown 46% over the five years to 2022[3] . This additional reporting burden may be easily absorbed by the largest listed companies, but the knock-on effect of this is the setting of standards that smaller, less resourced firms are finding harder to keep up with.

While high quality disclosure and transparency should be part and parcel of public life for a company, this may be a disincentive to today's business models at the earlier stages of their lifecycle. An increasing number of new companies' most prized assets are intangible in nature, and higher levels of disclosure compared to life as a private business may put them off making the switch to a public listing. Disclosing the location and detail of say, a resource company's mining assets, does not enable competitors to replicate that asset, but a software business may be reluctant to disclose too much information that offers clues to their success.

Intuitively, it follows that companies with the highest profitability and best growth prospects are likely to attract the most interest from private investors. Those who struggle to raise funds privately may see public offerings as a last resort, raising questions as to the longer-term effect this might have on the average quality of listed public market companies.

While public equity investors and the beneficiaries of public market investing may lament the declining opportunity set, it is worth considering their own role in another reason behind companies' reluctance to list. An intense short-term focus on earnings releases places pressure on management teams to play the earnings expectations game, distracting them from managing the business and making decisions for the long-term. Coupled with, at times, unnecessary one-on-one meeting requests by a long list of shareholders, no wonder staying private has appeal.

For retail investors, access to the burgeoning private markets sector is increasing. The listed closed end market has traditionally offered small investors access to privately held illiquid assets including the likes of venture capital and private debt, while regulatory regimes are also introducing open ended structures such as Long-Term Asset Funds in the UK. Enabling wider access to private markets to counter the trends occurring in the publicly listed space is positive, as this potentially gives investors exposure to those higher growing, profitable businesses that are choosing to remain private. Improvements are likely required in both markets, however. In private, a larger cohort of investors may demand more transparency from their investee companies, particularly those investors who are used to the disclosure received from their public market counterparts. For public markets, the old incentives such as a raised public profile and access to capital have eroded somewhat. Pragmatic changes need to be considered around reducing the burden of reporting for companies while promoting the benefits of a public market listing.

Sources: [1] Schroders plc. [2] McKinsey Global Private Markets Review 2024. [3] Quoted Companies Alliance - "A Never-Ending Story"

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