



Public v private

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There are many criticisms of publicly traded companies. Two are that managers either succumb to short-termism or rampant empire-building. The reason for these weaknesses, suggested as long ago as 1932, is that the separation of control from those who own the company results in a poor allocation of capital. This has been hard to prove, however, because the counterfactual – whether things are any better at private companies – lacks data.

A paper just released by New York University examines these criticisms with the help of a new database, compiled by Sageworks, on almost 100,000 private companies. It appears that public companies do indeed invest sub-optimally. But shareholders need not worry about chief executives building giant factories in their own image. Rather, public companies under-invest relative to private ones of a similar size. Between 2002 and 2007, the latter increased gross assets by an average of almost 10 per cent a year versus 4 per cent at listed companies. In addition, private companies appear to be more responsive to investment opportunities than public ones.

Analysis also shows a greater tendency to smooth earnings and dividends at public companies. Does any of this matter? After all, there is also a big advantage to being public, namely access to more plentiful and cheaper capital. The paper concludes, however, that the cost of poor investment decisions associated with short-termism is greater than the benefit from cheaper funding. So while it may be profitable to run a public company, it seems less sensible to own shares in one relative to a private company. A great advertisement for private equity funds, perhaps? Investors should remember, however, that such studies deal in averages. As ever for public markets, the name of the game is picking stocks.