Fewer Stocks, More Private Equity

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It's not generally known that the number of publicly traded stocks has fallen substantially, from more than 8,000 in 1996 to roughly 3,700 today. Does that mean that there are fewer companies today than there were three decades ago?

Actually not. Today, a growing number of companies are staying private, often owned, in whole or in part, by private pools of investment capital known collectively as private equity (PE). By one estimate, PE funds owned approximately 26,000 companies at the end of 2022, the most recent figures available. And some of the PE firms that have been buying companies have become the largest employers in America. Carlyle, KKR Private Equity and the Blackstone Group are the third, fourth and fifth-largest employers in America, right behind Walmart and Amazon.

PE firms finance themselves by raising capital from investors and then use the money to buy out publicly traded companies and take them private, or firms that have never gone public in the first place. The goal is to cut costs, strip out assets, and then eventually sell for a profit, sometimes to another PE firm. This structure is not very different from the infamous trusts of the 1910s and 1920s, which operated outside of regulatory scrutiny similar to the way PE-owned private companies today are not regulated the way public companies are. That earlier experiment didn't end well: there were well-publicized excesses, collapses, companies going out of business, bank runs and the Great Depression, among other things.

The PE firms are not just acquiring companies; a recent report found that three PE firms now own 11% of all the single-family homes for rent in Metro Atlanta—19,000 in all. The housing market in many American cities are adjusting to higher rents as for-profit firms buy up the available homes.

The trend has been to shift investment opportunities from what most investors are most familiar with—stocks—to blind pools managed by large firms who may not be long-term investors. Indeed the concern today is that PE firms are far more focused on maximizing short-term profits than they are at building the businesses they've acquired; on average, a PE firm expects to own a

business for four to six years, and there have been reports that sound a lot like the corporate raider days of the 1980s, where firms were acquired, picked clean, and then abandoned into bankruptcy.

Another concern is leverage. Not all the money used to buy these firms is coming from investors; the funds have tended to borrow heavily to make their purchases, making them subject to collapse as interest rates rise and interest expenses become higher than the models predicted. Leverage can create oversized profits, but it can also come back to bite the over-leveraged buyer.

What to make of all this? The first takeaway is that the stock market no longer represents the economy, and the disparity is increasing. But it's also possible that the publicly traded companies that most of us invest in will tend to have longer-term visions for their firms than the short-term-focused PE buyers, which means their longer-term prospects might be better. We won't know how all this will play out for some years to come. But in the past, this same movie has not given investors—or the U.S. economy—a happy ending.

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