# Half the Firms, Twice the Profits

The [American] Public Firm Transformed, 1996-2022

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## Half of America's public firms have disappeared since 1996

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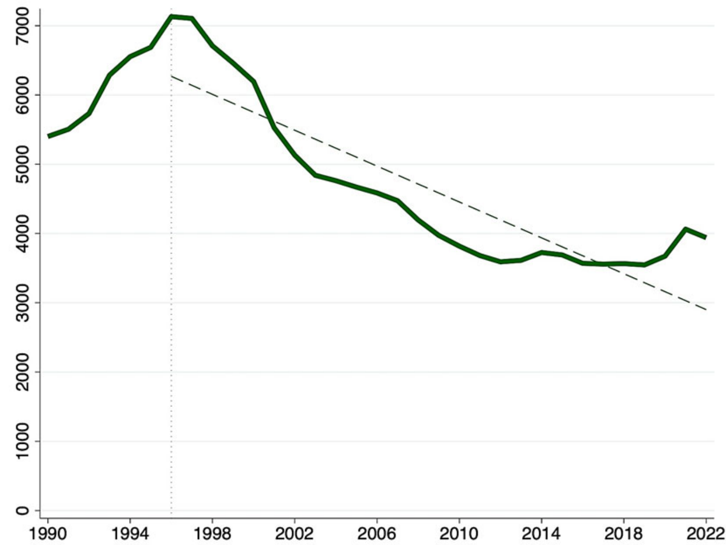
**Figure 1: Number of American Public Firms, 1990-2022**

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# Half of America's public firms have disappeared since 1996

- Halving often brought forward by those with deregulatory agenda
- Jamie Dimon, CEO JPMorgan Chase
  - "diminishing role of public companies"
  - "From their peak in 1996 at 7,300 to . . . now . . . 4,300"
  - "The trend is serious"
  - (Over-)regulation may be the main cause
- SEC Commissioners
- Law school courses
- Business media
  - "The publicly traded company is disappearing," boldly begins an October 2023 article in *The Atlantic*. Rogé Karma, *The Secretive Industry Devouring the U.S. Economy*, THE ATLANTIC, Oct. 30, 2023.

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# Explanations?

Wall Street Journal, 20th anniversary of Sarbanes-Oxley

- "On July 30, 2002, President George W. Bush signed the Sarbanes-Oxley Act."
- "Sarbanes-Oxley has permanently altered the landscape of business growth . . . ."

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OPINION

## The 20-Year Experiment Holding the U.S. Back

By John Berlau And Josh Rutzick

Many commentators these days, both progressive and conservative, decry a lack of opportunities for the American middle class, the concentration of certain industries under a few owners, and the tilt of startup funding toward a few large cities. An underlying cause of much of this is a bipartisan corporate-reform law enacted 20 years ago Saturday.

On July 30, 2002, President George W. Bush signed the Sarbanes-Oxley Act. The bill had cleared the Senate 99-0 and passed the House 423-3, with only Republican Reps. Mac Collins of Georgia, Jeff Flake of Arizona and Ron Paul of Texas dissenting. Coming on the heels of scandals at Enron and WorldCom, it was touted as a method for cracking down on accounting fraud at big companies and firms.

**The Sarbanes-Oxley Act has only hurt entrepreneurs and investors.**

Twenty years later, legitimate entrepreneurs and ordinary investors are punished by the law's costly mandates. Sarbanes-Oxley has permanently altered the landscape of business growth and development.

Before the law, midsize and even small companies could go to major stock venues for early growth capital. Many retail investors then grew in wealth as the companies succeeded. When Walmart went public in 1970, the chain had 38 stores, primarily in Arkansas and Missouri. When Home Depot went public in 1981, the chain had only four stores, all around Atlanta. The initial stock offerings of both firms was less than $10 million. Today, their market capitalization exceeds $300 billion each.

These companies weren't anomalous in going public at the early stages of their growth. This was the norm. A report by President Obama's Council on Jobs and Competitiveness found that in the 1990s, 80% of initial public offerings were smaller than $50 million. By 2010, 80% of IPOs exceeded $50 million. In recent years it has been fairly common to see companies—including Uber, Lyft and Robinhood—go public with IPOs in excess of $1 billion after they had already become household names. Retail investors didn't get to share in the growth of these companies before they became giants.

The costs of Sarbanes-Oxley are responsible for much of this shift in the size of newly public companies. Academic studies and annual reports show that the law has caused auditing costs to double, triple or even quadruple for many companies. A 2009 study by the Securities and Exchange Commission found that smaller public companies have cost burdens more than seven times those of large ones.

The disproportionate burden on small and midsize companies has spurred bipartisan criticism of Sarbanes-Oxley. As the Obama administration council noted: "Regulations aimed at protecting the public from the misrepresentations of a small number of large companies have unintentionally placed significant burdens on the large number of smaller companies."

One of Sarbanes-Oxley's most onerous mandates stems from the two brief paragraphs that constitute Section 404, which requires that public companies have effective "internal controls." The Public Company Accounting Oversight Board, a quasipublic rule-making agency created by Sarbanes-Oxley, has interpreted this section to mean full-blown audits of any company process that could enable "a reasonable possibility of a material misstatement in the financial statements."

This extremely broad standard, which reaches into all manner of company operations, has proved vexing particularly for businesses attempting innovation. According to John Battelle's "The Search," a history of the early years of Google, Sarbanes-Oxley was "hell for a company like Google, which made its money literally pennies at a time, from millions upon millions of micro-transactions." Mr. Battelle reports that "internal control" compliance significantly delayed Google's IPO, as the company "had to significantly restructure its advertising report system from the ground up."

Google eventually went public in 2004 in an IPO exceeding $1 billion, one of the largest ever at the time. But entrepreneurs who didn't have access to the venture capital heavily concentrated in the San Francisco area and a few other urban hubs weren't so lucky.

Some entrepreneurs may have sold their companies sooner than they otherwise would have, and some may have simply not been able to get products off the ground. Home Depot co-founder Bernie Marcus has stated repeatedly that he doesn't believe the company could have succeeded had Sarbanes-Oxley been in effect, as going public is what gave Home Depot the capital to open more stores.

Over the past 20 years, Sarbanes-Oxley has given investors few quantifiable benefits in preventing fraud. Perhaps the most memorable stain on its record is that it failed to catch the mortgage shenanigans that led to the 2008 financial crisis. A 2011 study in the International Journal of Disclosure and Governance found that by focusing on minutiae instead of major errors in valuing assets, Sarbanes-Oxley's "current control-centric approach misses the really big risks."

As the economy struggles with inflation and a recession, it's time to scale back the 20-year experiment that keeps ordinary investors and entrepreneurs from achieving America's full potential.

*Mr. Berlau is director of finance policy and a senior fellow at the Competitive Enterprise Institute, where Mr. Rutzick is a research associate. Mr. Berlau owns shares in Walmart and Robinhood.*

President Bush signs Sarbanes Oxley, July 30, 2002.

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# Two propositions in the paper

- First proposition, question: what's happening to the public firm sector overall?
  - Halving in numbers. Numbers peaked in 1996.
  - By every (every?) other measure, they are no less important to the economy
  - Package?: Fewer, more profitable, more valuable, larger
- Second proposition, question: why?
  - Corporate securities law explanation dominant (in legal circles)
  - I.O. Hypotheses
    - Two varieties
  - Seeking to explain two phenomena: (i) why public firms look the way they do and (ii) the declining number of public firms
    - If (i) is a package . . .

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# Motivation: At the SEC

- Since 2012, there have been 16 SEC commissioners, 13 of whom spoke on the declining number of public firms
  - All 13 had a legal explanation
  - About half agreed with the WSJ: over-regulation, esp Sarbanes-Oxley
    - (Cf. contra: Coates, Coffee, de Fontenay, Georgiev)
  - Half looked to deregulation of private capital flows, e.g., Reg D. Better private capital flow means fewer companies need to go public to get good access
- We'll call these two, combined, the **Legal Explanation** for the morphing public firm sector

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# Meanwhile, across town in D.C.

At the Federal Trade Commission:

- We examined the statements of FTC commissioners and ass't attorneys general in the Antitrust Division
- For why there is so much more concentration in the US economy
- Not identical issue
  - Fewer public firms (SEC) vs. more concentration among larger US firms (FTC)
- The SEC and FTC examine similar, overlapping phenomena
  - More concentration consistent with fewer firms
- I.O. Explanations:
  - #1: Antitrust
  - #2: New efficiencies from scale. "Winner-take-all" economy
  - We'll call the two the "I.O. Hypotheses"

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# Our Paper's First Proposition

Morphed structure: fewer firms, but more profitable.

Sector much more valuable.

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## Measures of public firm weight in the economy

- Total number of public firms. Total number of IPOs.
- Total value (Stock market cap/GDP).
- Total profits/GDP.
- Total capital spending/GDP.
- Total revenue/GDP.
- Portion of total employment

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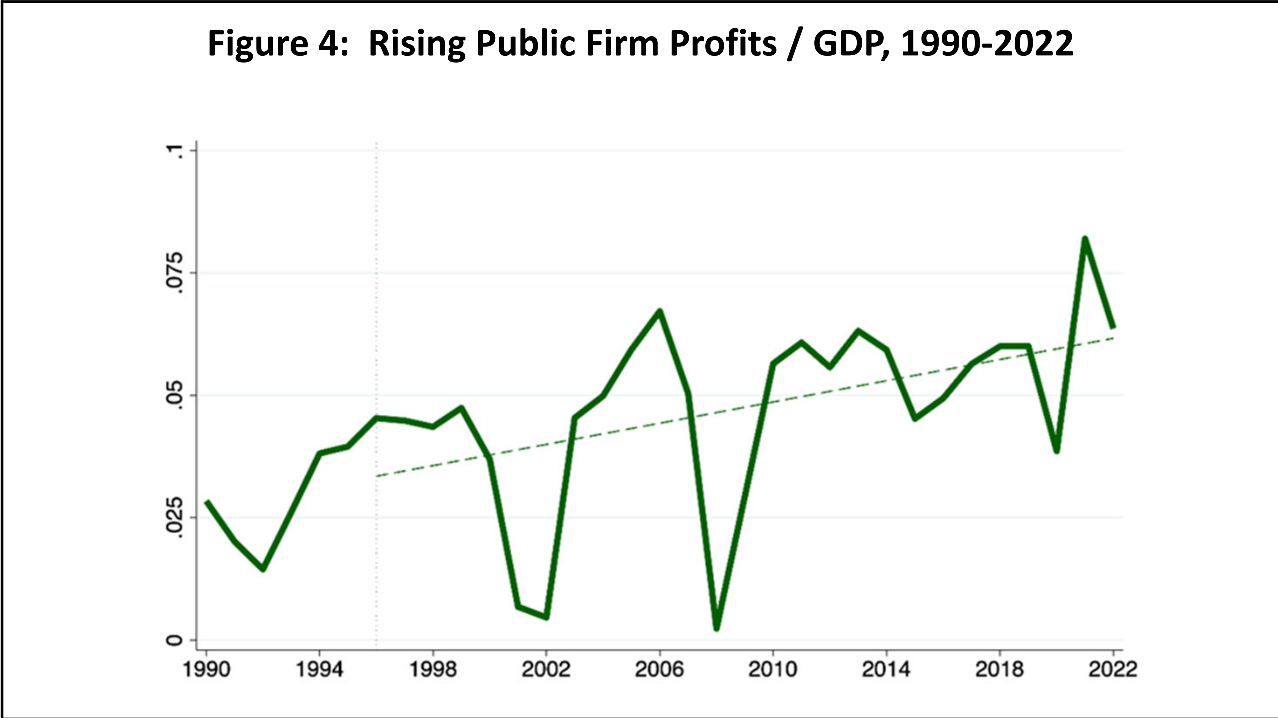


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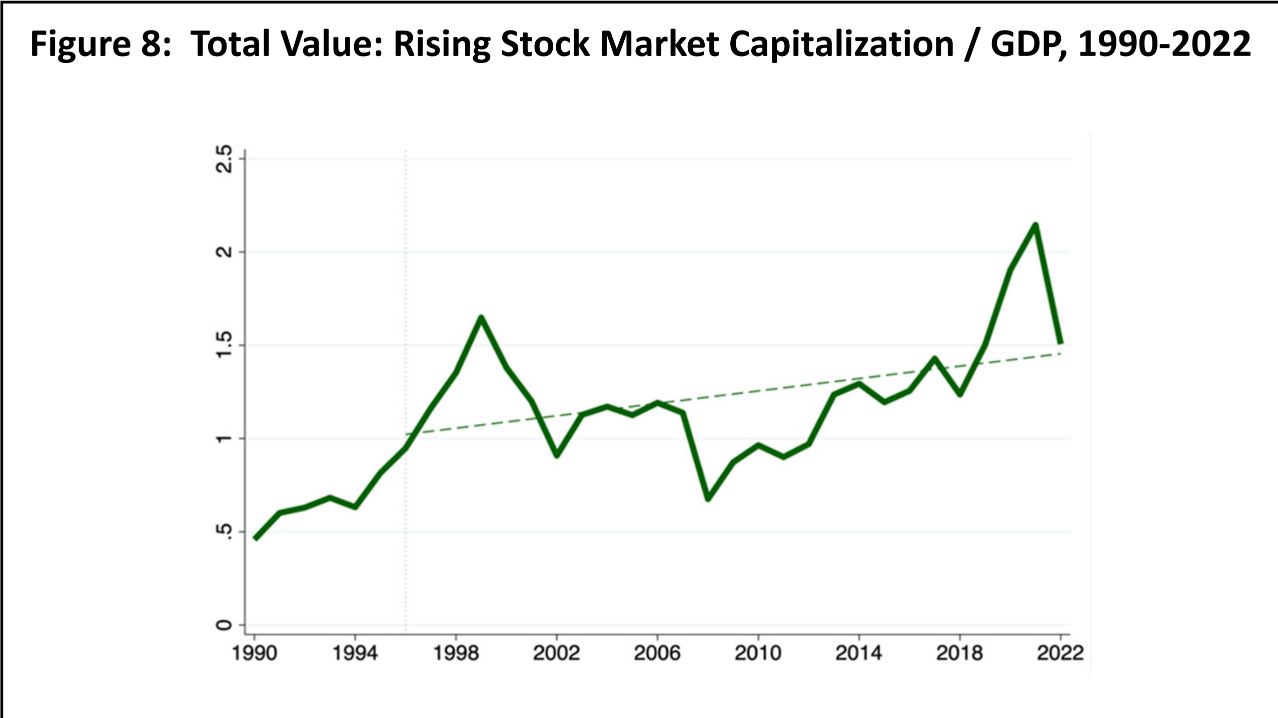


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## Similarly. . . .

- Rising profits before extraordinary items
- Rising economic profits
- Rising profit in non-FAANG firms
- Rising profit outside the S&P 500

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## Similarly. . . .

- Rising profits before extraordinary items
- Rising economic profits
- Rising profit in non-FAANG firms
- Rising profit outside the S&P 500
- EBIT, EBITDA:  steady from 1996 (rising from 1990)

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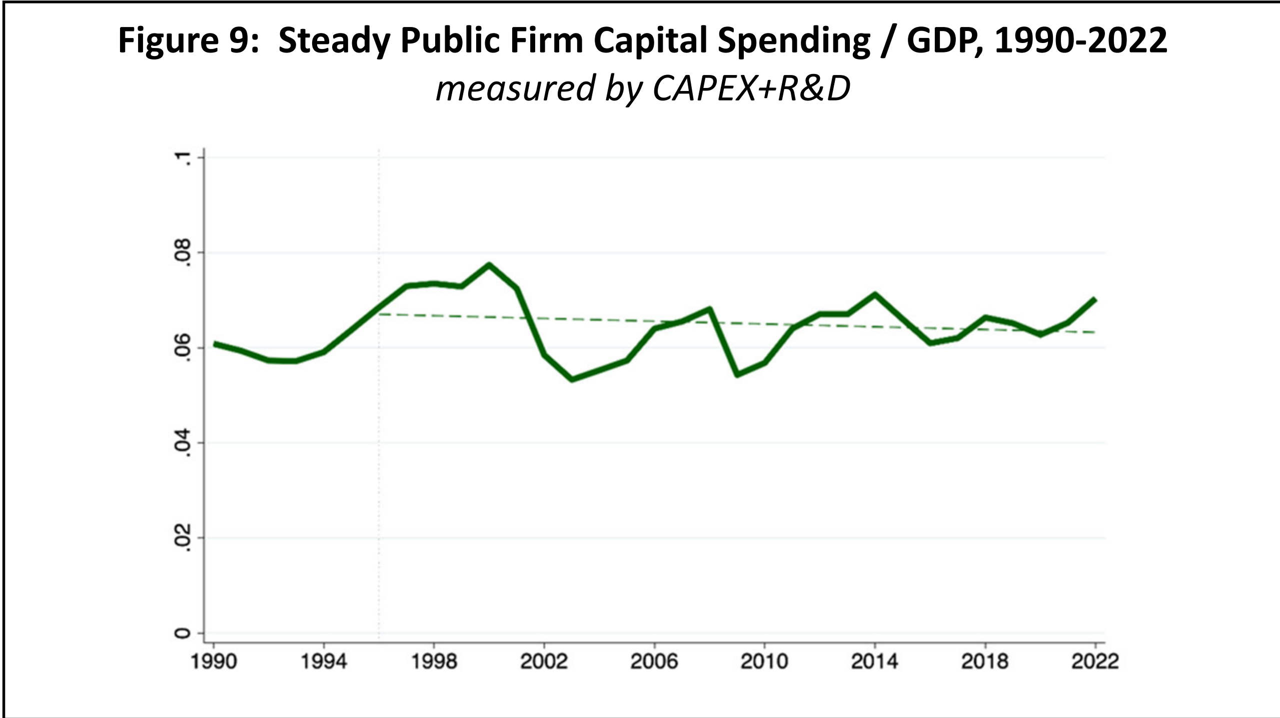


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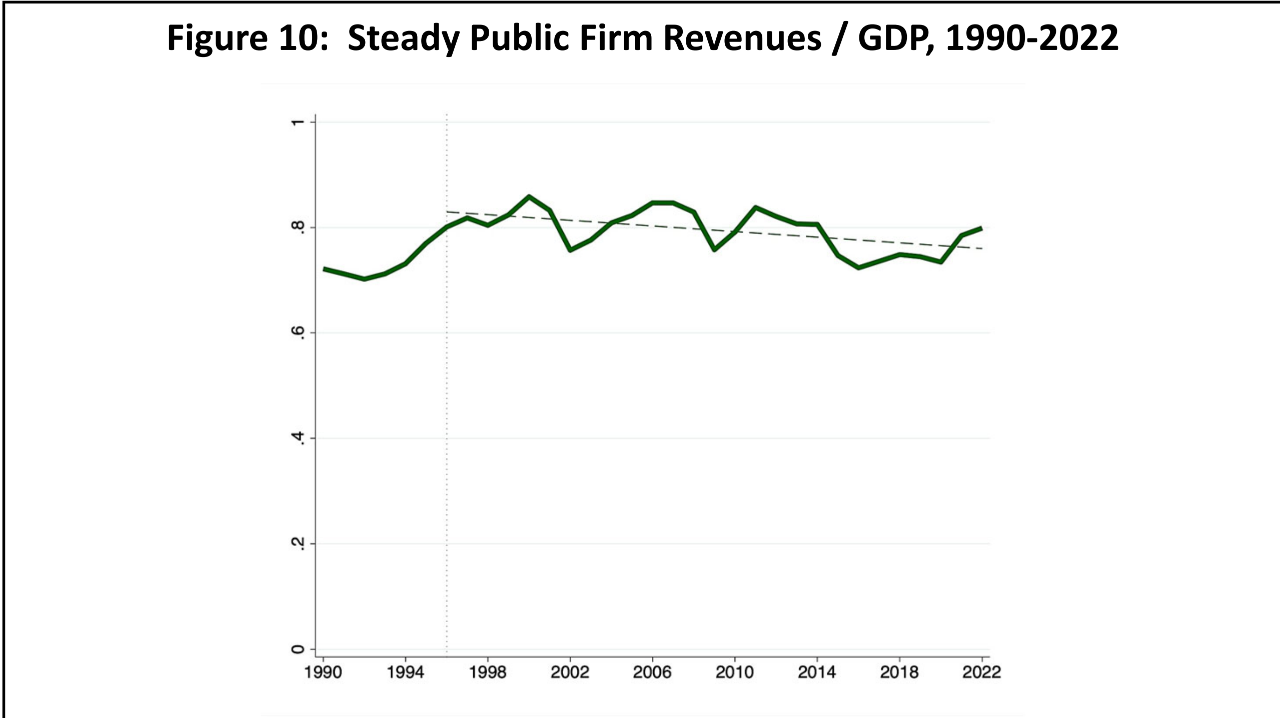


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## Basic evaluation

- By all characteristics that we examine, other than number of firms, public firms are today either more weighty (profits, market cap) or as substantial as they were in 1996.
- The only sharply declining characteristic is the total number of public firms

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## Casts doubt on regulatory perspective

- I.e., (over-)regulation of securities markets isn't driving business out from public stock markets
- Shouldn't use disappearing firms as an indicator of over-regulation of stock markets
- OR: at least need a more complicated explanation than the current:
  - Fewer firms implies over-regulation

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# The Second Proposition

Why?



## The paper's two major propositions

First assessment, public firms aren't disappearing.

- Focusing on the number of firms is misleading
- Public firms are growing about as fast as GDP by every other measure---or faster (profit, capitalization).

Second, inquiry/hypotheses: why?

- Two "why's"
- Why #1: Why are public firms now fewer but larger, more valuable, and more profitable?
  - I.O. Hypothesis to challenge the Legal Explanation
  - Evidence for I.O.>>evidence for Legal Explanation
  - A *package* of change?
- Why #2: Why are there fewer in 2022, as an *ind't* proposition?
  - I.O. Hypothesis is plausible.
  - But doesn't sweep away the Legal Explanations

## Fewer but larger: why?

- Legal Explanation
  - Over-regulation of public firm; less regulation of private firms
- I.O. Explanations
  - Less antitrust enforcement?
  - Changing economies of scale (and related I.O. configurations)

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## Assessment

- Public firms play a *more* important role in the economy than ever
- Over-regulation?
  - Legal and compliance costs
    - Non-compliance legal costs too
  - Rise in profit and value is measured in a ***trillion*** dollars. Rise in direct costs is a matter of ***billions*** of dollars.
  - Over-regulation of securities markets could help to explain disappearance of *small* firms, not *large* ones

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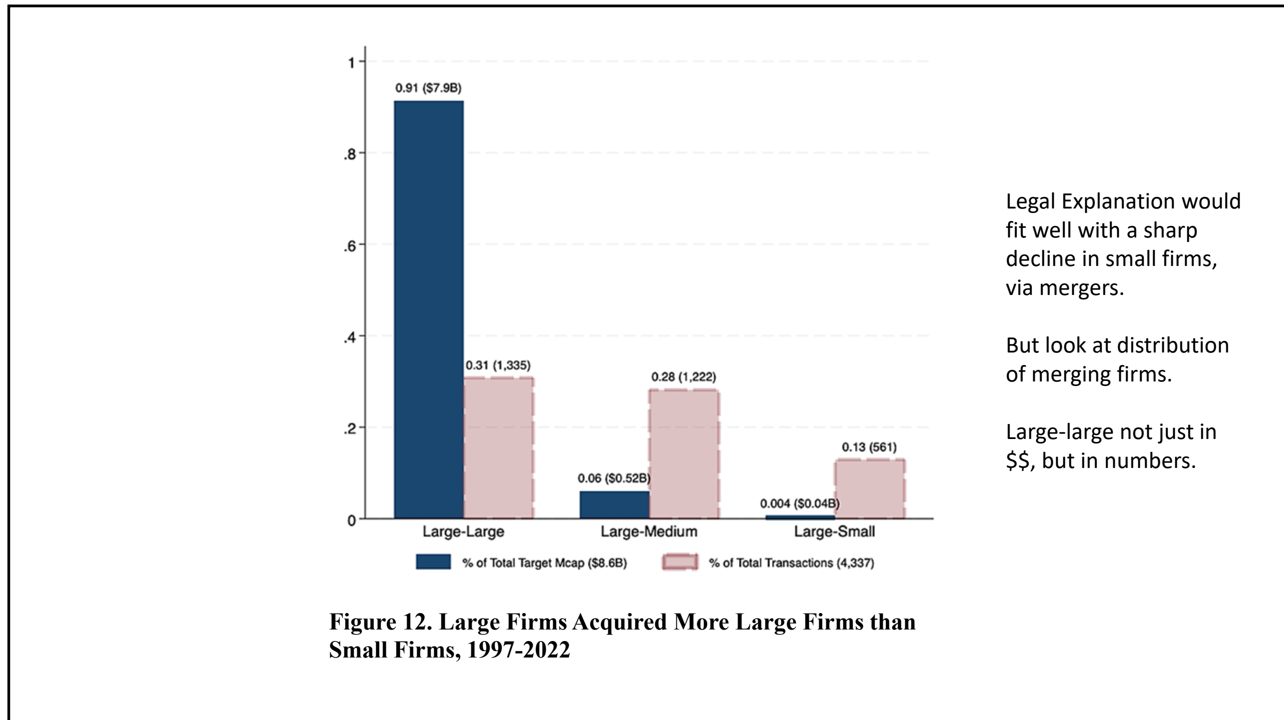


**Figure 12. Large Firms Acquired More Large Firms than Small Firms, 1997-2022**

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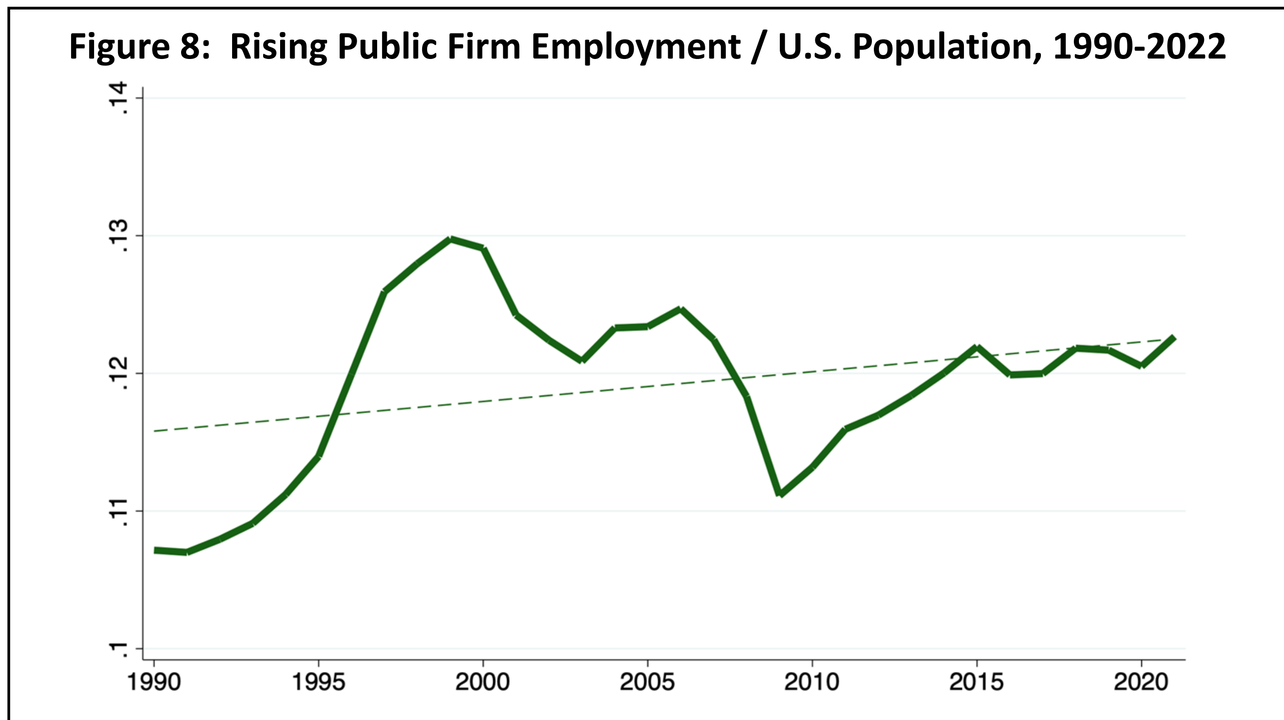


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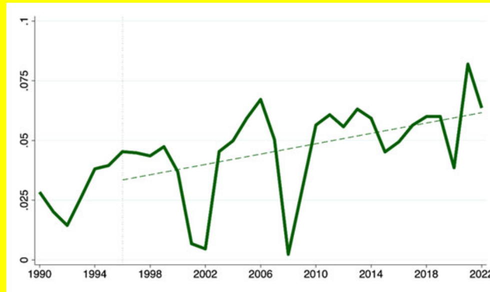
# Rising Profits [Figure 4]




Rise in profits/GDP in public firm sector

- Implausible that Legal Explanations doubled profits. Trillion-dollar issue. Several percent of GDP
  - Legal Explanation: Public firm is a more costly place to do business
  - Is it plausible that activism is killing public firms ***while total public firm profits are rising***?
  - Profits are rising faster than revenues and other basic corporate measures
- For the near doubling, need *more than compliance cost* to be in play
  - Some other major hit to public firms (but not to private firms)
  - I.O. Explanation, of some sort

  ---Likely to contribute to declining # of firms too.

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# Note different I.O. Explanations

- Simple but big: weakened antitrust, more mergers?
- Simple but big: economies of scale (I.T.? Telecommunications?)
- Others
  - Product cycles quickening?
  - Holding pen over?
  - Dotcom burst and then bust
  - Small firms need to get big faster now than before (Jay Ritter)

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## Any evidence of increasing concentration, declining competition in the U.S.?

- **Concentration and reduced competition (A)**
  - Thomas Philippon, The Great Reversal (2019).
    - EU vs. US
  - Eggertsson et al., The Rise of Monopoly Power in the United States (NBER, 2018).
- ***But see A' (contra A)*:**
  - Susanto Basu, *Are Price-Cost Markups Rising in the United States? A Discussion of the Evidence*, 33 J. ECON. PERSPS. 3 (2019).
  - Carl Shapiro, *Protecting Competition in the American Economy: Merger Control, Tech Titans, Labor Markets*, 33 J. ECON. PERSPS. 69 (2019).
  - Winner-take-all (Autor et al.)
- A and A' are I.O. reasons for fewer but bigger public firms

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## Public Policy Implications (for Corp. Law): I

- First: tone in SEC pronouncements is that
  - (i) public firms are disappearing and
  - (ii) ***we need to do something***---alter regulatory landscape.
- Disappearance should ***not*** be a major rationale to deregulate public firms securities and corporate rules

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## Public Policy Implications (for Corp Law): II

- I.O. Explanation plausibly in play. We cannot, however, exclude every Legal Explanation channel.
- BUT: Can impact corporate/securities law policy overall
  - SEC commissioners bemoan the diminishing number of public firms
  - They think the SEC might have had a major impact on this decline
    - (By burdensome regulation, by being too loose with private markets)
  - Our advice: drop that presumption and get to (difficult) other merits
  - Implication of the analysis: stop worrying (so much). It's not your fault to the extent the I.O. propulsion is more powerful than either Legal propulsion

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## Public Policy Implication (for Corp Law): III

- Ok, securities regulation didn't slash public firms in half.
- But here we are, with half as many public firms.
- That halving has ***consequences***.
- The consequences could affect what the ideal regulation is:
  - 1. Scale of enterprise more forbidding. Alienation.
    - Neo-Brandeisian antitrust
    - Revolt of the small business
  - 2. Could alter the quality and effectiveness of SEC-mandated information flow
    - Might disrupt capital flows if information degraded.
    - Discuss how and consequence
- (Deserves analysis. But consequences of halving are not the paper's focus.)

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## Conclusion

- Public firms are decreasing from their 1996 peak
  - ***In number***, but ***NOT*** by any other measure
- Why? SEC thinking ignores the I.O. Explanations
- Trends fit better with I.O. than Legal Explanations
  - Profits rising faster than GDP,
    - Consistent with rising returns to scale ***or***
    - Rising rents from other sources
  - Legal Explanations can't explain rising profits.
- I.O. Explanation should affect SEC's thinking
  - Decreasing number should not automatically be attributed to Legal Explanations

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