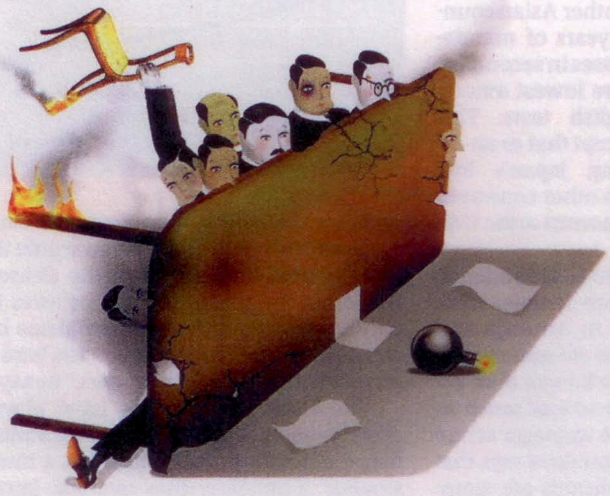
Schumpeter | The eclipse of the public company

Traditional listed firms are facing competition



FOR most of the past 150 years public companies have swept all before them. Wall Streeters have dissolved their cosy partnerships to go public. Communists have abandoned their five-year plans in favour of stockmarket listings. And Silicon Valley entrepreneurs have bowed before the god of the IPO—the initial public offering that takes a start-up public and makes its founders rich.

But is the sun finally setting on the public company? Its rise came at the expense of two older kinds of organisation that had dominated business until the middle of the 19th century—private partnerships and chartered companies. Private partnerships were wonderfully flexible but lacked the vital ingredient of limited liability: partners could lose everything they owned if the business failed. Chartered companies offered limited liability but were controlled by governments. Liberal reformers combined the best of both models: they gave managers freedom from government control and investors the shield of limited liability. Their invention conquered the world.

Yet now both the private partnership and the state-controlled company are making a comeback. Two of the world's three largest banks by market capitalisation are state-directed Chinese ones. The world's biggest telecoms company, China Mobile, is state-run. State-owned energy firms such as Russia's Gazprom and Saudi Aramco now account for more than three-quarters of the world's oil production. Many of these state-run giants resemble old-style chartered companies. They have the trappings of the private sector, such as boards of directors and listings on a stockmarket. But they are essentially instruments of state power. The Chinese government deems minerals vital to national security. So, like the East India Company of old, Chinese state-owned companies roam the world in search of raw materials and then build the roads and rails to ship them out.

Private partnerships are also on the march. A succession of legal changes in the United States—starting with a law in Wyoming in the 1970s and culminating in an Internal Revenue Service ruling in 1996—made life easier for them. Partnerships can now offer limited liability and issue tradable shares. They are more durable than before, since they are no longer destroyed when one partner leaves. They also escape from the double taxation that plagues the corporate sector: corporations have to pay corporate taxes and then their shareholders have to pay taxes on their dividends.

The result has been a revolution among small and mid-sized businesses in America. Larry Ribstein, a professor of law at the University of Illinois, calculates that about a third of American businesses large enough to file tax returns are now organised as partnerships or what he calls "uncorporations". Plenty of big businesses, too, are shunning the stockmarket, with its costly reporting requirements and impatient investors. Publicly traded partnerships and real-estate investment trusts mix and match features from corporations and uncorporations. Many big firms, such as Alliance Boots (a health-and-beauty group) have abandoned public stockmarkets and embraced private equity.

The most fashionable investment vehicles—leveraged buyout firms, hedge funds and venture-capital funds—are spearheading the "uncorporate" revolution. These firms are usually organised as partnerships, though some, such as the Blackstone Group, are also listed. Corporate raiders often raise money by creating funds in the form of partnerships. Their targets are often restructured as partnerships. This makes managers behave like owners rather than hired hands: they can lose money as well as making it and they have years to turn their companies around rather than answering to the stockmarket every quarter. Hedge funds can make money by buying companies and selling underperforming assets. Venture capitalists make money in the long term by lending their names and expertise to start-ups. Hedge funds and venture-capital firms also make money in their different ways by getting fund managers to behave more like partners, with "skin in the game", as the modish phrase puts it.

So where does this leave the public company? State ownership comes with too many handicaps to pose a long-term threat. Politicians may lean on the board to hire their idiot nephews, chase visions of national greatness or mop up the jobless masses. The biggest state-owned firms are often big only because they are shielded from competition. It is hard to avoid making money if you have a monopoly over Saudi oil, for example.

Unlisted private firms pose a challenge of a different order. They have undoubtedly established themselves as an alternative corporate form. And that is no bad thing. Just as an ecosystem benefits from diversity, so the world is better off with a multitude of corporate forms. Many big companies periodically need to undergo the sort of patient restructuring that they can only get when they leave public markets. That said, private companies have disadvantages that will hamper their growth. They lack public firms' rigorous systems of corporate governance and financial reporting. They depend too heavily on borrowing: many drank themselves silly during the credit boom and now have throbbing heads.

The qualified bliss of being listed

In fact, the public and private models of ownership have a symbiotic relationship. The reward for those who take a company private often comes when, having revived it, they take it public again. Venture capitalists would not put so much money and effort into nurturing start-ups if they did not dream of a lucrative IPO. Public companies may have had their confidence shaken in the past few years and their territory shrunken a little. But the organisations that were launched on an unsuspecting world in the mid-19th century still have a healthy spark of life in them. ■

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