The Shift from Public to Private Capital

A.J. LEVINE, CAIA, DIRECTOR
FEBRUARY 2025

Private markets have undergone a tremendous amount of structural change over the last several decades. 2024 brought these changes directly into the headlines. Select examples* include:

- SpaceX Valuation Jumps to About $350 Billion in Insider Deal – Bloomberg
- AI startup Databricks hits $62 billion valuation in record VC round – Reuters
- OpenAI raises $6.6B and is now valued at $157B – TechCrunch

It is noteworthy that the $350 billion valuation of SpaceX is larger than the entire U.S. micro-cap market. Databricks' $62 billion valuation would make it large enough to qualify for inclusion in the S&P 500 index. Nevertheless, their fundraising round was still oversubscribed. These striking capital commitments and valuations would almost certainly not have been possible even a decade ago.

This note builds on recent comments from Jared Weiner, Pathstone's managing director of private markets: Private Markets - Changing Market Structure Benefits Scale. We provide an overview of the market evolution over the past few decades, and how we navigate these new dynamics in evaluating investment opportunities for our clients.

What Changed in Private Markets?

Three closely related dynamics have significantly altered the private markets landscape:

1) After peaking at over 8,000 in 1996, there are just under 5,000 public U.S. companies today (see chart below). Further, public markets have grown more concentrated, with a small number of companies driving performance. (For additional insights from our team on market concentration, please see The Magnificent Seven: Leading the AI Revolution.)

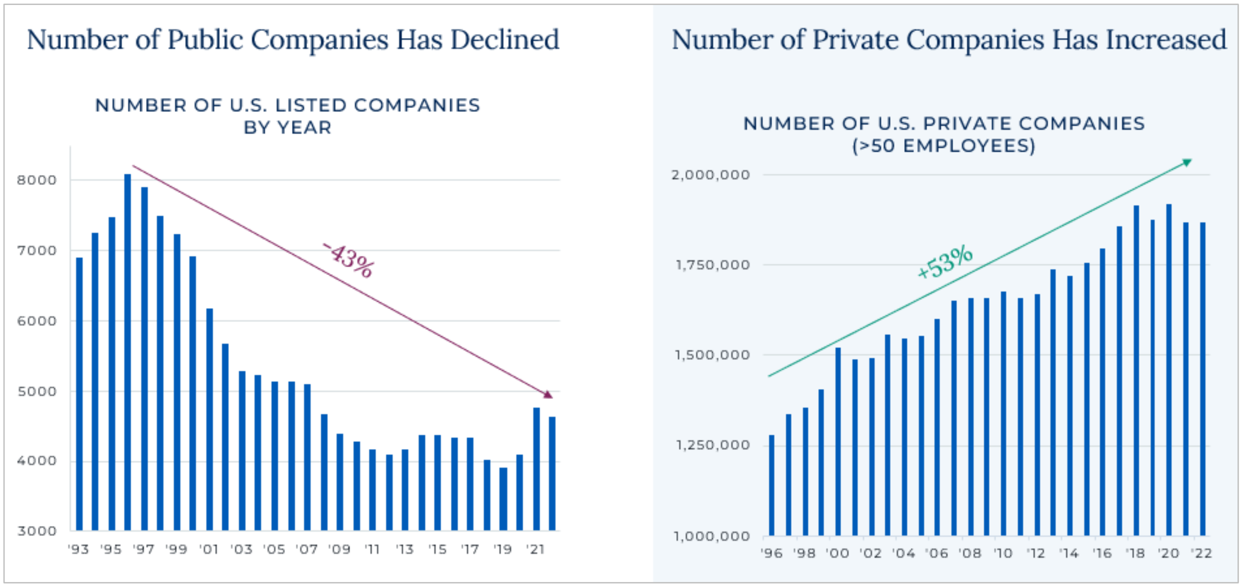
2) Private equity assets under management (AUM) in the U.S. has nearly doubled in the last five years to around $3.5 trillion, according to PitchBook. Newer transaction types have gained traction as market participants continue to specialize.

3) There are fewer initial public offerings (IPOs) and on average companies are waiting longer and until they are larger before listing.

Fewer Public Companies, More Private Investment Opportunities

Going public was once considered necessary for privately backed companies to achieve growth beyond a certain size, but today there are significant challenges that come with listing on the public markets. Regulatory hurdles, operational demands, and the pressure to meet quarterly expectations may hinder long-term growth. As a result, many companies are choosing to stay private. In fact, the number of private companies increased by 53% between 1996 and 2022, as shown below.

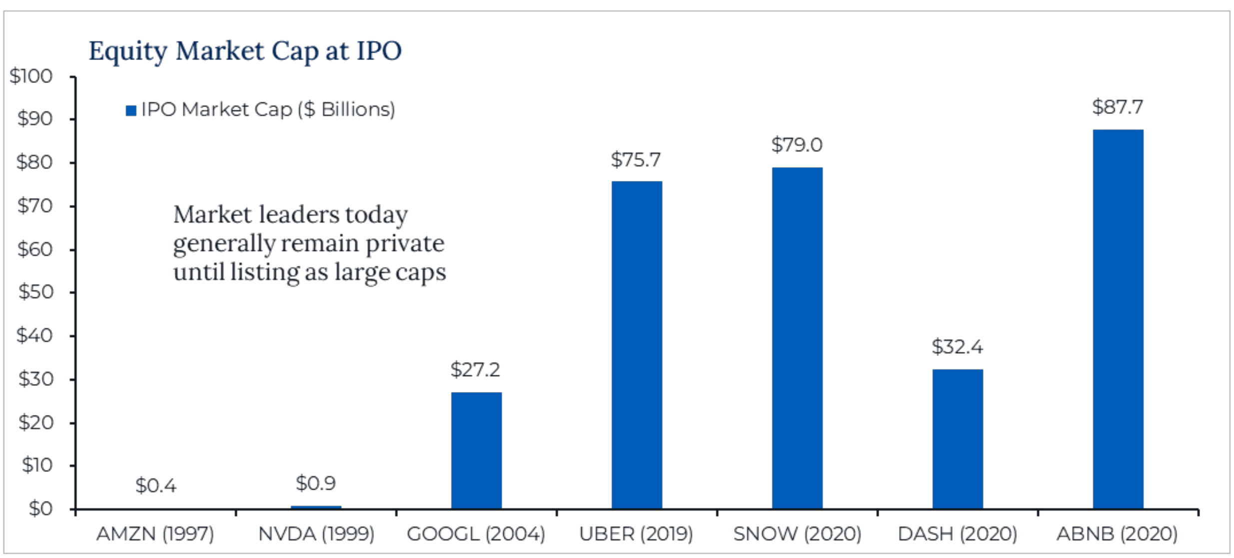
* Companies cited for illustrative purposes only and do not constitute investment recommendations.



Source: Data from KFF; Pathstone, World Bank.

Growth of the Market Facilitates Longer Private Lifespan

In the past, a company's IPO would bring access to deeper and more permanent capital structures to fuel future expansion. For example, when Amazon and Nvidia went public in 1997 and 1999, respectively, both had market capitalizations of less than $1 billion. Today, these companies are market leaders with a combined market value exceeding $5.5 trillion. Crucially, these companies needed to go public to raise capital, and over 99% of the today's total value was captured by public shareholders.



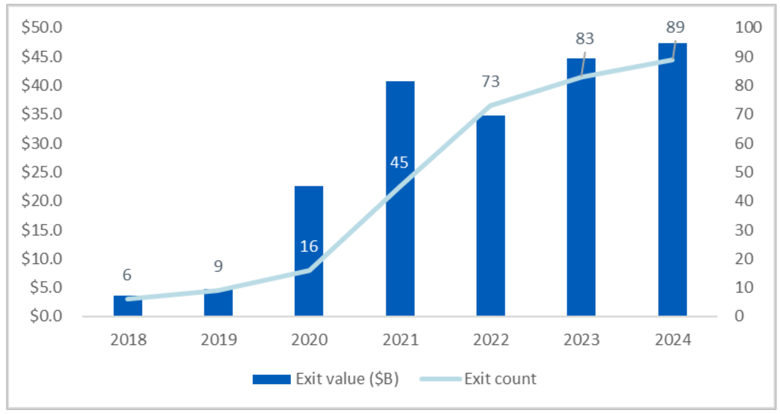
Source: Data from KFF; Bloomberg, University of Florida, Pathstone.

However, the landscape has changed. Now, leading companies can remain private for longer, and private shareholders are capturing a larger share of the growth. While technology IPOs are less frequent than in years past, those that do occur are often much larger. Furthermore, the growth and specialization of the secondary market is playing an important role in this shift.

The Growing Role of the Secondary Market

A secondary transaction occurs when an investor elects to sell their interest to another party prior to the investment's maturity date. The transaction allows existing investors to generate liquidity earlier, while new investors can buy into existing pools of assets, often at a discount. While sales of limited partner (LP) interests used to dominate the secondary market, increasingly general partners (GPs) are also facilitating these transactions, known as GP-led secondaries. In 2025, we expect the number of GP-led secondary transactions to surpass 100. These transactions play an important role, providing a liquidity option to existing private investors while giving new capital providers the opportunity to enter. This trend of private companies staying private longer is being supported by these emerging liquidity mechanisms, which meet investor demands and help maintain capital flows within the private market.

Private Equity GP-led Secondary Exit Activity

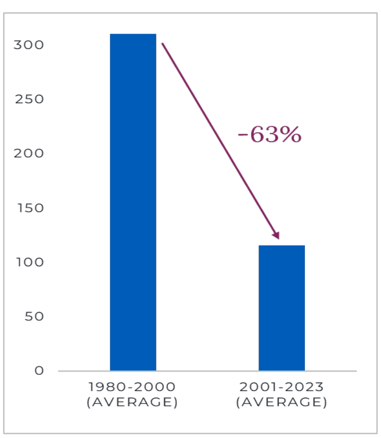


Source: PitchBook: Pathstone as of October 31. 2024.

The IPO Market Has Changed

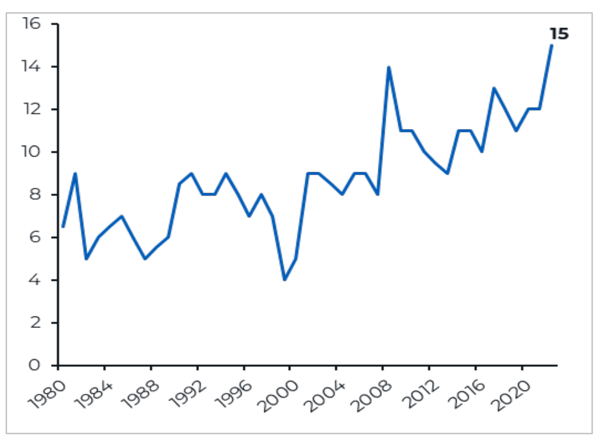
The number of IPOs has significantly decreased in recent years. While we expect a relatively supportive environment for IPOs in the coming years, we believe that, on average, IPOs will remain a more limited exit option compared to past decades. Scale is now a critical factor, as IPO candidates tend to be larger and more mature. For example, in the 1980s, the median age of a U.S. technology company at the time of its IPO was just over six years. Today, that median age has risen to more than 15 years. This shift is partly due to the increasing availability of private funding, which allows companies to delay going public until they are more established.

Number of IPOs



Median Age of Tech Companies at IPO

US Equity Listings



Source: Data from KFF; Bloomberg, University of Florida, Pathstone, as of 9/30/24.
https://site.warrington.ufl.edu/ritter/files/IPO-Statistics.pdf

Do Changes in Market Structure Provide Opportunities for Investors?

In short, yes. Our team has been discussing these shifts for quite some time, and we are confident that there are compelling opportunities ahead. However, several important questions remain:

- How can clients best capitalize on these changes?
- Which managers are best positioned to navigate these new dynamics?
- What new investment strategies will emerge over the next cycle?

One thing is clear: private investors are now capturing more value throughout a company's lifecycle than ever before. While there are many strategies with solid return potential, we are focused on identifying and underwriting strategies we believe are positioned to take advantage of the dynamics outlined above.

If you have any questions or would like to discuss private markets further, please contact us.