Research highlights how public and private companies differ

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A professor in the UO's Lundquist College of Business has found a creative way to draw accurate comparisons between public and private

firms, providing important new insights into the way the two types of businesses operate.

Albert Sheen, an assistant professor of finance, used data on what are known as commodities chemical companies from 1989 to 2006 to analyze similar publicly and privately owned firms. His work showed that private firms are more likely to invest in additional capacity as demand for their product is on the rise, while publicly traded firms are more likely to invest into slumps.

Sheen noted that publicly traded companies generally have access to less expensive capital. Access to easier money, combined with having less of an ownership stake than private managers do, might motivate public companies to believe that boom times will persist.

He also finds evidence that savvy private firms tend to sell assets to public firms just before a downturn.

"Private firms are more likely to strategically choose to build when industry utilization is high and acquire when utilization is low," Sheen wrote.

The results of his research and analysis appeared in a recent paper published in the Journal of Financial and Quantitative Analysis titled "Do Public and Private Firms Behave Differently? An Examination of Investment in the Chemical Industry."

Both scholars and investors wonder frequently if management teams at publicly traded firms respond to different incentives than executives at privately held companies and, by extension, which ones make the best decisions. It's an especially relevant issue for private equity and venture capital investors as companies remain private for longer.

According to a 2015 article in Barron's magazine by Jeremy Abelson and Ben Narasin, the average age of a company going public was once four years. By 2015, it had grown to 11 years.

But bridging the evidence gap is difficult. Private company management teams don't publicize their company financials and don't regularly have to explain their decision-making. Their blunders may go unnoticed. That means comparisons between public and private firms can be difficult, if not impossible.

To get comparative data, Sheen turned to chemical commodities companies. In that industry, private firms like Cargill and Koch Industries are often similar in size to their public peers. And although Sheen didn't have access to the financial data for private firms, he was able to see when private companies built new factories or expanded existing facilities, because those initiatives are often publicized and covered by media.

Because these companies deal in traded commodities, and because the chemicals used or produced by one firm are identical to those used and produced by another, Sheen demonstrated that the public and private firms are subject to the same boom and bust cycles, providing a common benchmark to measure corporate decision-making.

Professor Sheen observes that public companies invest at or near the tops of markets. That doesn't suggest management teams at public firms are less competent, Sheen said. Building capacity within the sector takes time, so it could be that public companies are able to draw on and use capital most cheaply during boom times.

By the time the additional capacity is brought online, he said, the cycle may have shifted. Public firms tend to respond more to past demand shocks. Private firms, drawing from a smaller but steadier pool of

capital, may be more cautious or countercyclical.

Also, Sheen suggested, "stronger managerial incentives from a tighter linkage between ownership and control, a hallmark of private equity-run firms in particular, is a possible mechanism."

More information: Do Public and Private Firms Behave Differently? An Examination of Investment in the Chemical Industry. jfqa.org/2019/05/29/do-public- … e-chemical-industry/

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