MEKETA

Investing in Small Companies via Private Equity

CONTRIBUTORS
Luke Riela, CFA
Lauren Giordano
Frank Benham, CFA, CAIA

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In 1996, the US public equity market included roughly 8,000 listed companies. Today, that number is closer to half of that, even as the total value of the US stock market has grown many times over. Much of that decline has occurred at the small end of the market, the very segment institutional investors have long relied on for early access to high-growth companies, diversification away from large cap concentration, and the potential for manager alpha in a historically less efficient corner of the public markets. The natural question this raises is not whether small companies still exist, but where investors now need to look to find them.

This paper examines that question. It traces the historical rationale for small cap equity investing, the structural forces behind the decline in the number of public small cap companies, and the corresponding growth of private capital as an alternative path for these companies to raise funds and grow. It then considers whether the characteristics that once drew investors to public small cap equity, along with the potential for manager alpha, have carried over to private markets, and it weighs the tradeoffs that come with accessing this opportunity through private equity rather than public equity.

Key Takeaways

- **The public small cap opportunity set has structurally shrunk, but it has not disappeared.** Rising IPO costs, reduced sell-side coverage following decimalization, and a steady wave of delistings and take-privates have reduced the number of public small cap companies, though a sizable public universe remains.
- **Private equity offers a channel to a similar population of small, high-growth companies, largely independent of listing status.** The size and stage-of-development characteristics that historically drove small cap's return and diversification appeal appear tied to company size rather than to whether its shares trade publicly.
- **The growth of private capital is both a cause of, and a proposed answer to, the shrinking public opportunity set.** Rising availability of buyout, venture, growth equity, and private credit funding has allowed companies to raise capital and scale without going public, actively accelerating the same decline it is simultaneously offsetting.
- **There is no clear evidence that small cap manager alpha has migrated to private markets.** Despite private market returns carrying naturally higher dispersion (and hence greater potential to add value), interquartile spreads for both US small cap equity and US buyouts show no meaningful trend over the past 20 years.
- **Accessing this opportunity through private equity carries real tradeoffs that can offset its appeal.** Illiquidity, heavier due diligence requirements, valuation lags, and materially higher fees all weigh against the opportunity, and the benefit of manager selection depends on access to top-quartile funds that are often oversubscribed.

The Historical Rationale for Small Cap Equity Investing

Historically, publicly traded small capitalization ("small cap") companies offered investors early access to some of the fastest growing, profitable opportunities via their stock. One of the primary reasons for investing in these small cap stocks was effectively known as the "small stock effect" and has been well documented since the early 1980s.[1] The historical data showed that smaller cap US stocks had outperformed larger cap stocks, on average, historically. This outperformance was influential enough to later be formalized as a distinct risk factor, known as the size premium, in academic models. Some academics argue that this premium existed because small cap stocks were also inherently less liquid than their large cap counterparts, and investors were being compensated through a liquidity premium. And though singular small cap stocks present substantial business risk, as a whole, it is possible to diversify away much of this idiosyncratic risk with the hope that there are a few large scale "winners" in the basket.

Beyond the small stock effect, investors have historically also been drawn to small cap equities as a way to gain early access to companies before they matured into the market's largest names, effectively buying tomorrow's large caps while they were still small and, in some cases, arguably underpriced. Smaller companies were also typically earlier in their growth trajectory, often generating faster revenue and earnings growth than their larger, more mature counterparts, and they have historically represented a common target for acquisition, giving investors the potential for an additional return through takeover premiums. Similarly, small cap equity was considered a largely inefficient asset class, leaving more opportunity for active managers to identify and act on mispricings (i.e., to add value via "manager alpha").

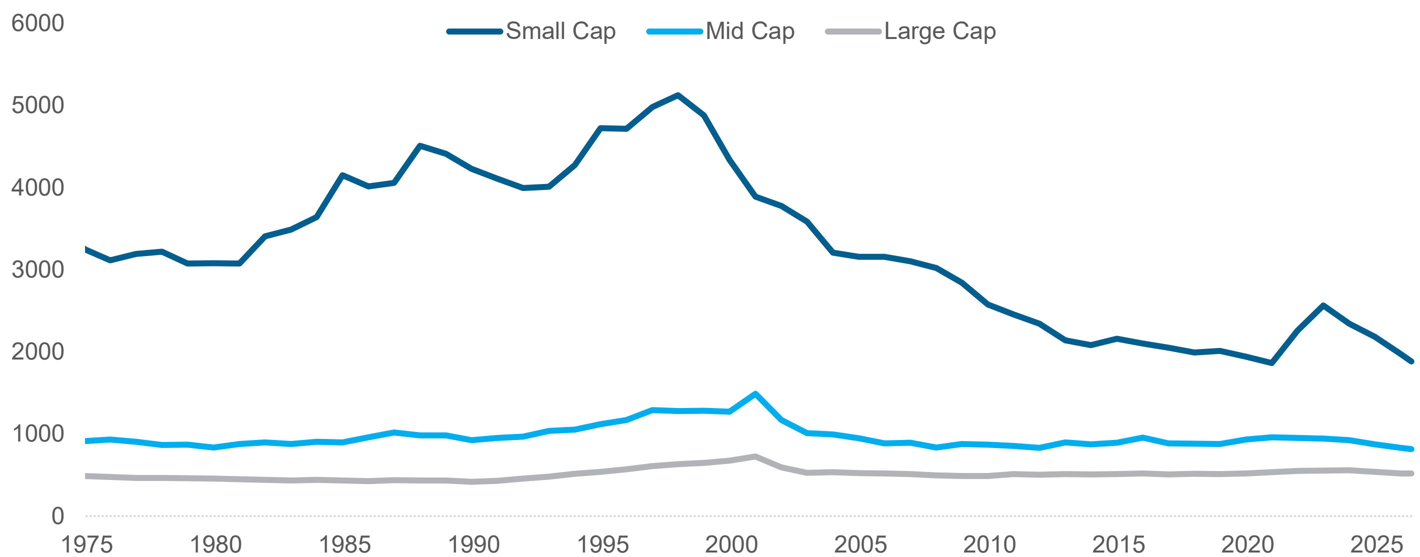
Small cap equity's appeal also extended beyond stock-level return characteristics to the diversification benefits it offered at the portfolio level. The universe of small cap stocks tends to have different sector compositions and be much less concentrated than the US large cap equity indices. Small cap companies have also tended to derive a greater share of their revenue domestically, giving investors a different exposure to the US economy and less sensitivity to the international and currency factors that impact the multinational large cap names that often dominate broad equity benchmarks.

A Shrinking Opportunity Set

The opportunity set of available US small cap stocks to invest in is no longer the robust universe it once was. The overall number of public stocks in the US has fallen since its peak in the 1990s, driven primarily by a shrinking number of small cap names (see Figure 1). While the number of mid cap and large cap stocks also peaked around the turn of the century, their totals have remained relatively stable since the 1970s; it is the small cap segment that has seen the sharpest and most sustained decline. Several structural forces help explain this decline.[2]

Figure 1

Number of Publicly Traded US Companies



Source: Fama, Eugene, and Kenneth French, Tuck School of Business at Dartmouth Kenneth R French Data Library, accessed July 14, 2026. Public company data is monthly, only the year-end month is shown in the chart. Public data is based on the CRSP universe and includes common stocks listed on NYSE, AMEX, and NASDAQ with size breakpoints determined annually each June using NYSE market equity percentiles.

Fewer companies have chosen to go public in the first place. The costs and burdens of an initial public offering, from underwriting, legal, accounting, and exchange listing fees to the ongoing compliance costs of being public (heightened by regulation such as Sarbanes-Oxley), have made an IPO a less attractive path for smaller companies. Changes to US equity market structure have compounded this: the shift to decimalized stock pricing in the early 2000s reduced the profitability of market-making and trading in small cap names, prompting many sell-side firms to scale back small cap research coverage. With less analyst coverage and institutional attention available to reward a small cap listing, fewer smaller companies have found it worthwhile to pursue one, even as later initiatives such as the JOBS Act attempted to ease the path to market for smaller issuers.

At the same time, the pool of already-public small cap companies has been shrinking. Companies have been delisted from US exchanges for various reasons, including failing to meet listing standards, while a steady wave of mergers and acquisitions, including public-to-public combinations and take-private transactions led by private equity, has consolidated many smaller listed companies into larger public or private owners.[3]

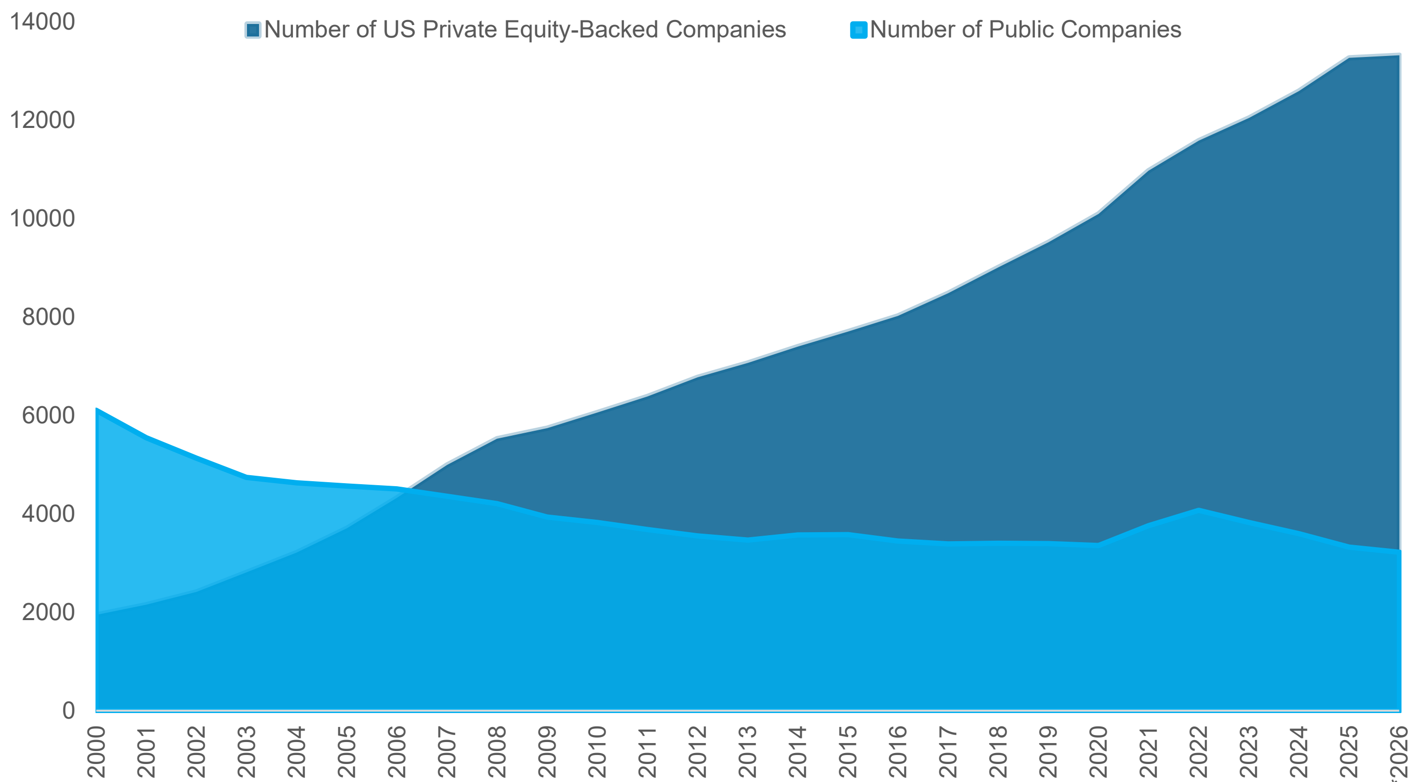
Compounding these trends, the growing availability of private capital, including buyout, venture, growth equity, and private credit funding, has given companies a viable and increasingly attractive alternative to the public markets, allowing many to raise substantial capital and grow while remaining private for longer, or indefinitely. This leads to both a drop in the current availability of small cap US stocks as well as a decline in the pipeline of small cap companies entering the public space.

The Migration

While there remains a large opportunity set in the public space for small cap stocks (though the pool is smaller than what it historically has been), the "new" trend is the growing number of small cap companies in the private sector. Figure 2 depicts the stark contrast between the decline in public companies and corresponding rise in private equity-backed companies. This leads to the appearance that the small company investment opportunity has not so much shrunk as migrated.

Figure 2

Number of Public Companies versus Private Equity-Backed Companies



Sources: PitchBook's Q1 2026 US PE Breakdown, US PE-backed company inventory, as of March 31, 2026. Fama, Eugene, and Kenneth French, Tuck School of Business at Dartmouth Kenneth R French Data Library, accessed July 14, 2026. Public company data is monthly, only the year-end month is shown in the chart. Public data is based on the CRSP universe and includes common stocks listed on NYSE, AMEX, and NASDAQ with size breakpoints determined annually each June using NYSE market equity percentiles. 2026 data is as of March 31, 2026 for US private equity-backed companies and as of May 31, 2026 for US public companies.

The decision by these small cap companies to stay private for longer, or indefinitely, follows directly from the dynamics discussed above: as long as private capital remains available, the ongoing burdens of being public continue to outweigh the benefits of a listing for many companies. The growth in private equity (and broader private markets) means it is both a cause of the shrinking public opportunity set as well as the solution that it is proposing to resolve. In other words, the private sector is not simply a parallel destination that the opportunity set migrated to on its own; it was a driving factor that actively accelerated the decline of the public opportunity set.

Remaining private also gives companies greater control over their strategic direction. Private ownership allows management to make long-term investment and operating decisions without the scrutiny of quarterly earnings expectations, public market volatility, or the threat of activist shareholders that often accompanies a public listing. Companies with significant intangible assets, such as proprietary technology or trade secrets, may similarly prefer to remain private to protect this information from the disclosure requirements that come with being public.

The consequence for investors extends beyond a smaller opportunity set to a later entry point. Companies that go public today tend to do so at a considerably more advanced stage than they once did. The average age of a company at IPO was roughly 9.5 years from 1980 to 2019, but rose to approximately 14 years by 2024.[4] Revenue at the time of listing tells a similar story. Companies with revenue of more than $500 million at IPO made up around 12% of IPOs from 1980 to 2000, but increased to roughly 27% from 2001 to 2025.[5] The population of private companies valued above $1 billion, commonly referred to as "unicorns," had also grown to more than 1,200 as of mid-2025, a population that barely existed a generation ago.[6] Taken together, this suggests that a meaningful share of a company's growth, and the return associated with it, may now accrue to private investors well before a public listing occurs, if one occurs at all.

Accessing Small Companies via Private Equity

As established above, small cap companies are increasingly choosing to remain private for longer, or indefinitely, and the public small cap opportunity set has structurally shrunk as a result. For investors who have long valued small cap equity for its distinct return and diversification characteristics, this leaves two paths forward: accept a smaller and more concentrated public small cap universe or find a way to access these companies while they remain private. Private equity offers the latter path, giving investors a direct channel to the population of small, high-growth companies that used to be reached primarily through the public markets.

The characteristics that historically made small cap stocks attractive are largely a function of a company's size and stage of development, not whether its shares trade on a public exchange. Investors can access the desired early-stage, high-growth opportunities small cap equity once provided through venture capital, growth equity, and buyouts, each corresponding to a different point in a company's lifecycle. In each of these stages, the goal remains the same: for the company to grow and become more profitable, eventually leading to a public listing, a sale, or a higher valuation.

This lifecycle progression has an important implication for timing. Public small cap equity has historically provided investors with access to companies early in their growth trajectory. As companies spend more time, and reach a larger scale, in private hands before any listing, investors who wait for a public listing to gain exposure are likely gaining exposure later in a company's growth trajectory than investors did a generation ago. Private equity offers one way to narrow that gap, providing access to companies during the venture, growth equity, and buyout stages that increasingly precede, or in some cases replace, a public listing altogether.

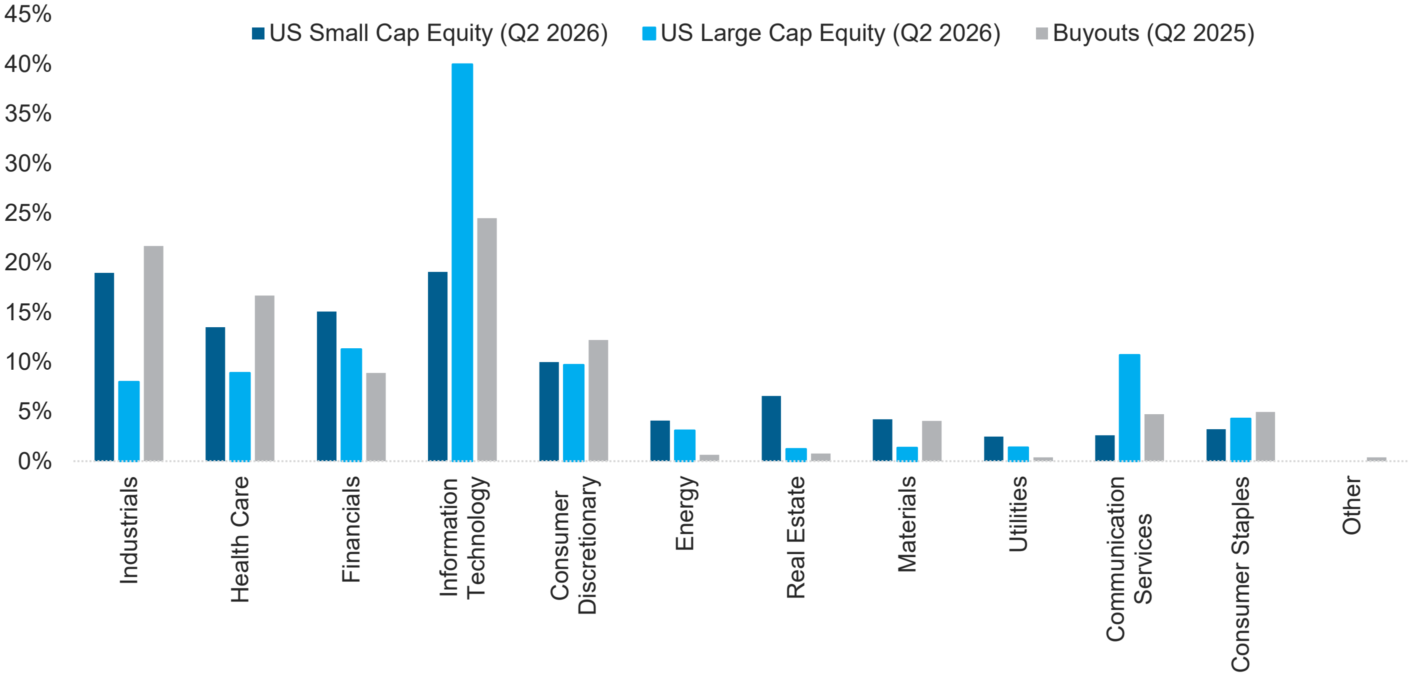
Investments in small companies via private equity may also provide similar diversification benefits to those small cap public equity historically provided. These benefits may include differences in sector composition and less concentrated performance drivers.

For example, lower technology exposure and higher exposure in other sectors like materials and industrials is present in both US small cap equity and buyouts, meaning the traditional small cap equity benefit carries over to the private sector as well (see Figure 3).[7]

The historical performance of US buyouts has likewise followed similar trends as US small cap equity (see Figure 4). This is unsurprising since broad economic growth serves as a factor driving the long-term performance of both categories.

Figure 3

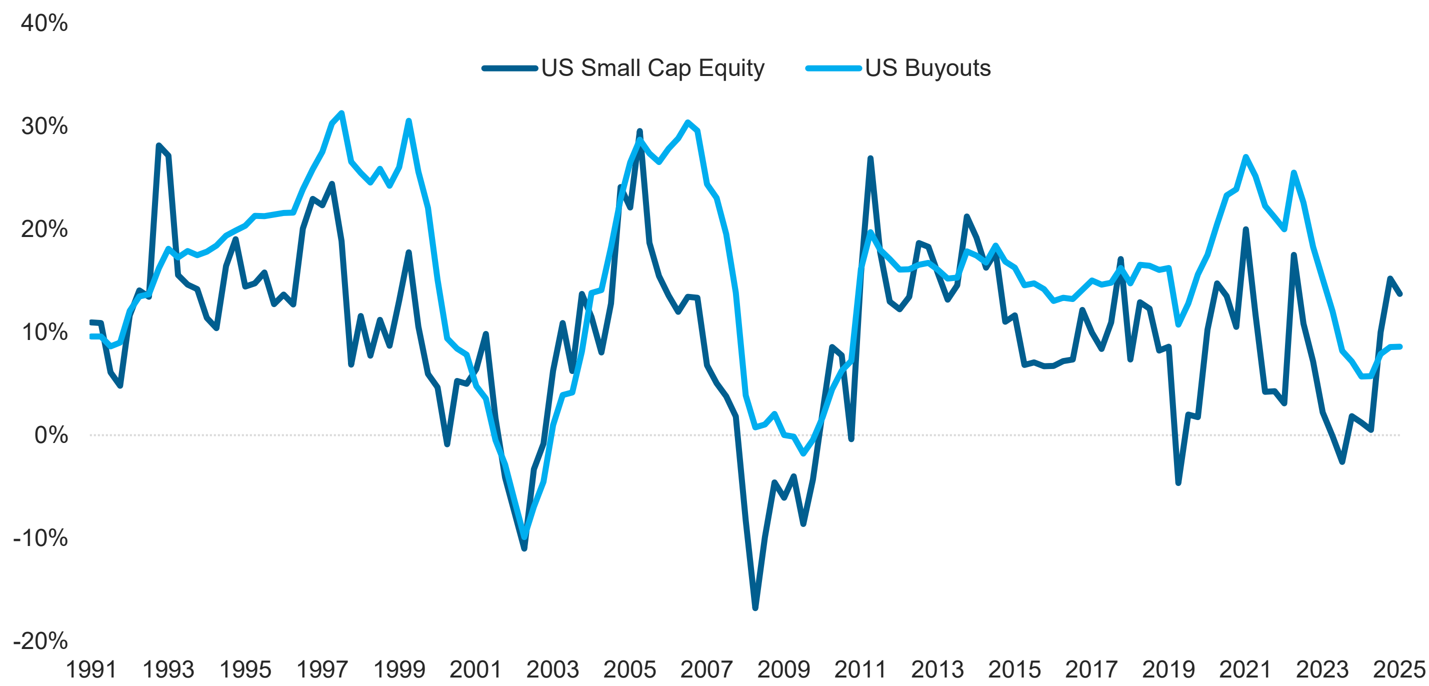
Sector Composition



Sources: MSCI US Small Cap Equity and MSCI US Large Cap Equity Factsheets, as of June 30, 2026, and MSCI Private Capital Q2 2025 Benchmarks Report: Buyouts, as of June 30, 2025. Buyout sector breakdown based on aggregate NAV and is global with 61% in US, 28% in Europe, 6% in Asia, and 5% in other. Throughout this paper, US buyouts are used as the private market counterpart to US small cap public equity for comparison purposes (instead of venture capital). Buyouts tend to target established, cash-generative operating businesses concentrated in sectors similar to public small cap, unlike venture capital, which tends to target early-stage, pre-profit companies with a fundamentally different risk-return profile.

Figure 4

Rolling 3-Year Annualized Return



Sources: Cambridge Associates via IHS Markit and InvMetrics as of December 31, 2025. Indices used: Russell 2000 and Cambridge Associates US Buyouts Composite. Private data was pulled in May 2026 and is net of fees. For purposes of return comparison, we linked quarterly IRRs of Cambridge's US Buyout Composite as reported by Cambridge Associates. This is because time-weighted returns for these series were not available, and the quarterly IRRs used should not differ materially from time-weighted quarterly returns. Note that the trailing returns we present by linking the quarterly IRRs are different from the trailing IRRs, as the trailing IRRs are running the calculation over a longer period in which the weighting of cash flows has a more substantial impact.

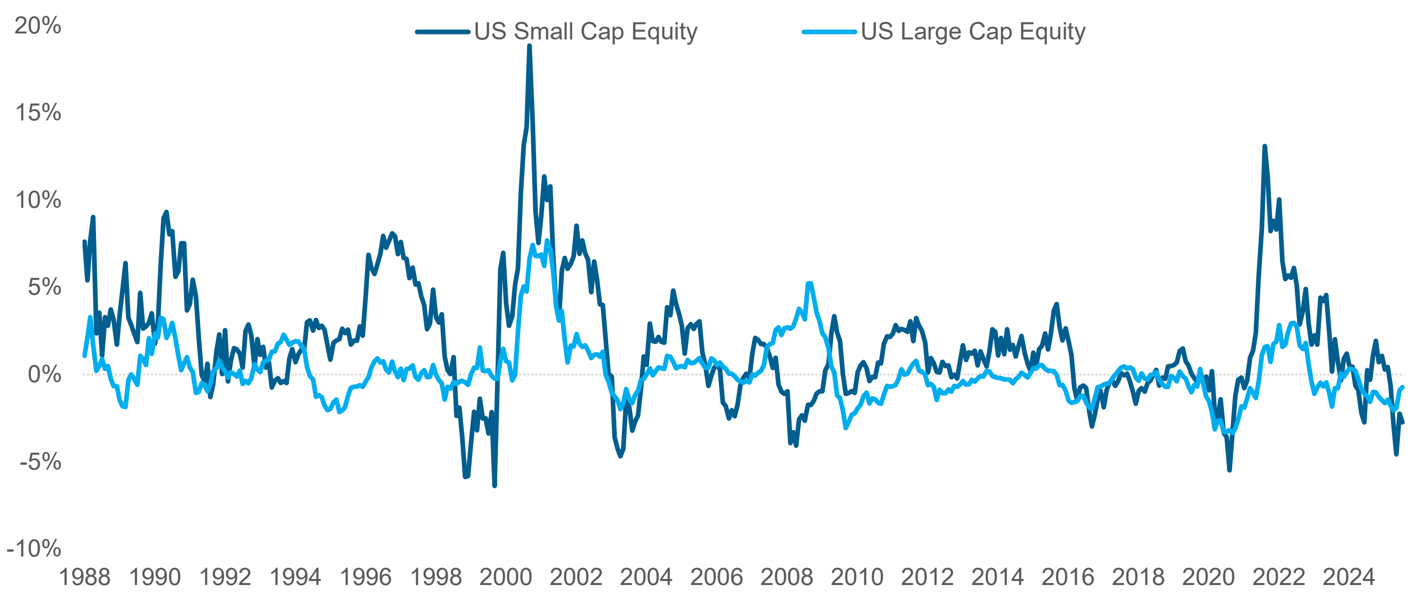
Has Alpha Migrated Too?

One of the other reasons for investing in US small cap equity used to be a philosophical belief in the ability of active managers to outperform the benchmark (i.e., generate manager alpha). For many years, there was support for this in the data, as the median manager tended to outperform the benchmark, gross of fees, and do so more than in several other public market asset classes, notably large cap equities (see Figure 5). However, somewhere around the mid-2000s, the median outperformance declined to a point such that it was not meaningfully different from zero, though it has been highly cyclical when evaluated over periods as short as a single year.

The partial migration of the opportunity set of small companies from the public sector to the private sector raises the question of whether the alpha generating opportunities historically present in US small cap stocks have also moved (and may be in part responsible for the diminished median manager alpha). One way to quantify this change is by evaluating interquartile spreads, which can be thought of as how much potential value lies in selecting superior active managers.[8] Private markets inherently have much greater dispersion in their returns compared to public markets and thus naturally have higher interquartile spreads (i.e., top managers can potentially add greater value). One way to test this is to compare the interquartile spread of US buyouts with that of US small cap equity over the same period. If buyout dispersion has widened while small cap dispersion has narrowed, that would help answer the question.

When comparing the two, it is important to note that while both are measuring interquartile spreads, this is not an apples-to-apples comparison. The underlying data is constructed using entirely different methodologies. Small cap public equity spreads are based on time-weighted returns, which we use to calculate manager returns over one year minus the benchmark return and then use those to calculate the percentiles for the interquartile spread. Private equity buyout spreads are based on IRRs and the percentiles used to calculate the interquartile spread are provided by Cambridge Associates.

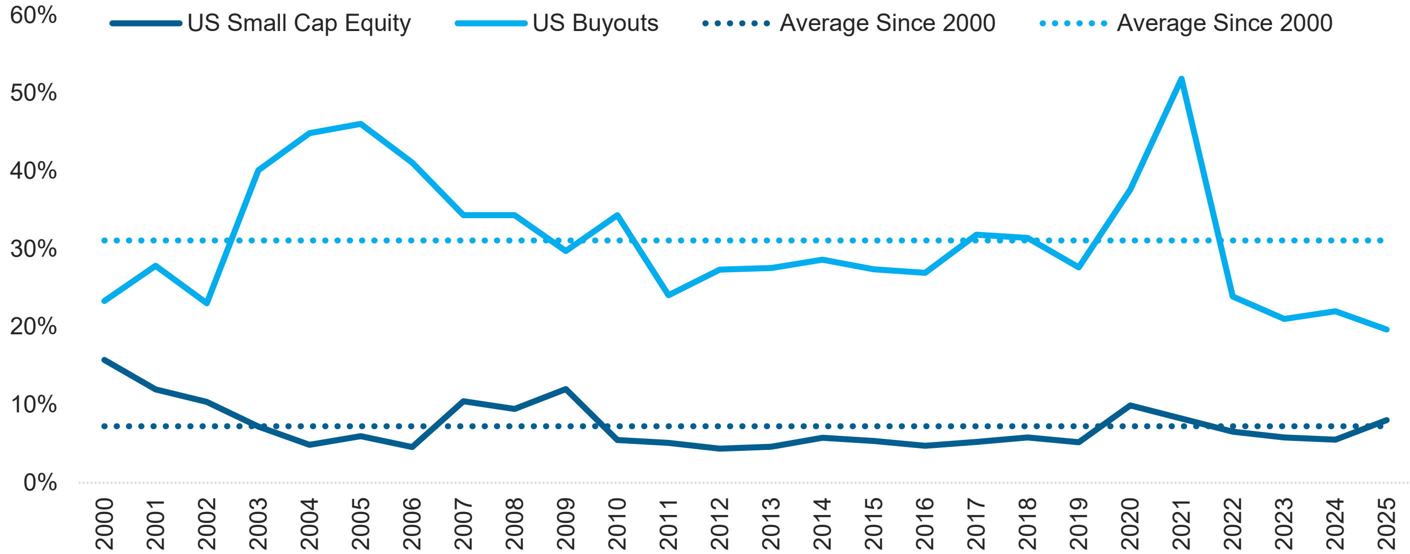
Figure 5
Median Manager Outperformance



Data Source: eVestment, as of December 31, 2025. eVestment US Small Cap Core Equity Universe and eVestment US Large Cap Core Equity Universe. Reflects rolling median one-year performance minus the respective benchmark performance over that same period, gross of fees. Net of fees results would be lower.

Figure 6

Calendar Year-end Interquartile Spreads



Sources: Cambridge Associates via IHS Markit and eVestment as of December 31, 2025. US Buyouts is the calendar year-end interquartile spread (based on IRR returns) provided by Cambridge Associates. US Small Cap Equity is the calendar year-end interquartile spread of one-year manager returns minus the benchmark. For more information on US small cap equity's filtering and calculation, see Meketa's Manager Alpha whitepaper. The buyout data shown in Figures 4 and 6 is presented net of fees, so the two series are not on a consistent fee basis and are not directly comparable on that dimension.

Although these two interquartile spreads are not measuring precisely the same thing, the overall conclusion appears well supported. There is not sufficient evidence to conclude that US small cap equity's alpha generating potential has necessarily "moved" to the private sector (see Figure 6). Neither the interquartile spread of active US small cap equity nor that of US buyout funds shows a meaningful trend upward or downward over the past 20 years.

An Opportunity Not Without its Tradeoffs

Accessing the potential small company opportunity via private markets is not without its tradeoffs. Investors must be aware of the differences and complexities that a private equity investment typically involves compared to a publicly traded investment.[9]

Perhaps the most significant difference is the inherent illiquidity of private equity. Whereas public small cap equity funds are generally open-ended and allow investors to buy and sell positions on a daily basis, private equity funds are typically closed-end vehicles with a finite life, often a decade or longer, over which capital is called and returned on the manager's timeline rather than the investor's. Investors should carefully review and project their anticipated future cash flow needs to ensure that they can tolerate this reduced liquidity, meet capital calls as they arise, and avoid becoming a forced seller in the secondary market for private fund interests. Because any single fund reflects only a point-in-time commitment, building and maintaining a target allocation also requires an ongoing pacing program, with commitments spread steadily across vintage years to smooth deployment and diversify the timing risk of investing in any single market environment.

Private equity also requires considerably greater due diligence than public equities. With no continuous market price and less standardized public disclosure, evaluating a fund requires assessing the manager's track record, team, strategy, valuation practices, and operational infrastructure. Ongoing measurement is likewise more complex: benchmarking private equity performance is not as straightforward as it is for public equities. Reported valuations are subject to lags and perceived smoothing effects, because underlying holdings are marked periodically rather than priced continuously by the market, which can understate the investment's true economic volatility.

Manager selection is critical, as exemplified in the earlier section that showed the wide dispersion between top- and bottom-quartile private equity managers. Capturing the opportunity depends on securing access to top-performing funds, which are frequently oversubscribed and closed to new investors. Additionally, fee structures are both meaningfully different and typically higher than those of public small cap strategies. Private equity fees generally pair a management fee with performance-based carried interest and present a larger obstacle for net-of-fee performance.

Conclusion

The shift in where small companies choose to build and scale, from public markets toward private ownership, is not a temporary market condition but a structural change in how these businesses access capital and manage their growth. For institutional investors, this means the choice is no longer simply whether to hold small cap equity, but where along the public-private spectrum to seek that exposure. An allocator who maintains only a public small cap mandate is, whether deliberately or not, choosing to participate in a narrower and more concentrated slice of the small company universe than existed a generation ago.

This does not argue for abandoning public small cap in favor of private equity, nor does it suggest the two are interchangeable. Public small cap equity remains liquid, transparent, and straightforward to implement and monitor, characteristics that private markets cannot offer. Private equity brings its own return and diversification potential, but also illiquidity, higher costs, and a dependence on manager access that public markets do not require. The appropriate response is not a wholesale reallocation but a deliberate decision, informed by an institution's liquidity needs, governance capacity, and tolerance for the operational complexity that private investing entails.

Manager selection remains central, though the tools available to exercise it differ. In public markets, any investor can access the broad small cap market passively, and the value of selection among active managers has narrowed as median alpha has declined. In private markets, the potential value of manager selection is wider, but realizing it depends on securing access to funds that are often oversubscribed and closed to new capital, a constraint that tends to be less common among public markets managers. Investors evaluating a shift toward private small company exposure should weigh this access question carefully.

Public company counts in the small cap segment show no evidence of reversing course, and the capital available to keep companies private for longer shows no sign of receding either. Investors who want continued exposure to the small company opportunity, in whichever form it takes, will likely need to become more comfortable operating across both public and private channels, and should treat the decision of how to allocate between them as an active and ongoing one rather than a one-time determination.

End Notes

1 See, for example, Fama, Eugene and French, Kenneth. "Size and Book-to-Market Factors in Earnings and Returns." Journal of Finance 50 (1995) 131-155. This followed the work of Rolf Banz in "The Relationship Between Return and Market Value of Common Stocks" published in the Journal of Financial Economics in 1981 and Richard Roll in "A Possible Explanation of the Small Firm Effect" published in The Journal of Finance in 1981. In more recent decades, the small stock effect has been highly debated after seeming to have declined or disappeared since initially being discovered. See Meketa's paper "Small Cap Stocks: Strategic Allocation" for a more detailed discussion.

2 See "The Decreasing Number of Public Companies" by Meketa, 2025.

3 Some sources have also argued that when adjusting for mergers, the post-1996 drop in the number of US public companies is not as drastic. See: Eckbo, B. Espen and Lithell, Markus, "Merger-Driven Listing Dynamics," April 17, 2024, Journal of Financial and Quantitative Analysis, Forthcoming, European Corporate Governance Institute – Finance Working Paper No. 752/2021.

4 Source: Ritter, Jay R. "Initial Public Offerings: Median Age of IPOs Through 2025." University of Florida, accessed July 2026. Age is defined as the calendar year of the IPO minus the calendar year of founding.

5 Source: Ritter, Jay R. "Initial Public Offerings: Sales Statistics Through 2025." University of Florida, accessed July 2026. Sales figures reflect the last twelve months of revenue prior to the IPO, adjusted to 2024 dollars.

6 Source: CB Insights, as cited in "IPO Market: Startups Staying Private Longer with Alternative Capital," CNBC, October 7, 2025. Figure reflects private companies valued above $1 billion as of July 2025.

7 Due to data limitations, we use global (instead of US-only) buyouts, more than half of which are US-based.

8 Interquartile spreads are measured as the difference between the 25th and 75th percentile manager.

9 For a more thorough review of private equity's intricacies, see Meketa's Private Equity Primer.

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