Money-Losing Companies Mushroom Even as Stocks Hit New Highs

The percentage of listed companies in the red is close to 40%

By
James Mackintosh
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Tesla Inc. shares have doubled in three months, while General ElectricCo. shares are up 44%. The pair are the two most valuable loss-making companies, part of a shockingly high proportion of listed companies that have been losing money—despite, or perhaps because of, the long bull market.
While Tesla and GE couldn't be more different, they are exemplars of two trends driving the rising number of loss makers. Tesla shows a desire by investors to back disruptive companies as they build their sales. GE represents a growing number of companies struggling to make money from traditional businesses—although GE bucks a third trend, which is that many of the unloved losers are small companies being squeezed by the growth of giant corporations.

The combination of forces has pushed the percentage of listed companies in the U.S. losing money over 12 months to close to 40%, its highest level since the late 1990s outside of post-recession periods.

This time there's no recession, and stock market indexes are at or near record highs. That sounds scary, although it's mainly worrying for investors in smaller companies.

Tesla is the biggest of the loss makers investors like; although it posted a rare profit in the most-recent quarter, it has lost money over 12 months. With a market value of $89 billion, it is worth more than Ford and General Motors put together despite only four prior quarters of profit in its 12-year life.
Investors who back Tesla are right not to care too much about near-term profit. They think Tesla's success in building an electric-car brand will translate into far higher sales, and that takes spending. It would, of course, be better if charismatic Chief Executive Elon Musk could find a way to do it all more cheaply and with less drama, but what really matters for now is that sales go up. (Personally, I'm skeptical that Tesla can grow quickly enough to justify its sky-high valuation, but current earnings are still barely relevant.)

Tesla is part of a broader pattern. The proportion of U.S.-listed companies losing money for three years reached its highest last year in data stretching back to the late 1990s, according to calculations by Andrew Lapthorne, global head of quantitative research at Société Générale.

Investor tolerance of losses shows up most obviously in new issues, where about three-quarters of IPOs were made by loss-making companies last year, according to University of Florida finance professor Jay Ritter.

What type of companies are losing money? In the U.S., 42% are health-care companies, reflecting the popularity of small, often loss-making biotech stocks. Another 17% are tech stocks, many of them fashionable new ventures.

For traditional companies like GE, investors have had little tolerance for losses until recently. A combination of a slow-growing economy, a failure to keep up with changing consumer habits and competition from well-funded disrupters has driven lots of companies into loss, especially smaller stocks. And these aren't the sort of losses that investors appreciate.

Because GE's days of rapid growth are far behind it, investors have really cared. Its shares have lost two-thirds of their value since 2016, when shareholders woke up to its troubles.

Yet, GE has been a prime beneficiary of the dash for trash in the stock market in the past few months. Not only GE, but previously unloved loss-making stocks more generally have made back some of their previous price falls.

Here we come to the third trend: Smaller companies being squeezed. The shares of three-quarters of the 100 biggest companies that reported losses rose over the past 12 months, because big loss-making companies tend to be growth stories where investors don't much mind the losses. That's far above the 41% of all loss-making U.S. companies whose shares rose, because smaller lossmakers really suffered, according to data from S&P Global Market Intelligence.

Among the smallest 80% of companies, there has been a long-term increase in persistent loss makers—those losing money for three years. The proportion of these loss-making companies rose after each of the last two recessions and didn't come down again afterward. The story should be familiar by now: Many small companies are being dominated by the biggest corporates, squeezing them out of markets and crushing their ability to invest for growth.

Investors should be concerned about the long-term effect of the decline in competition that is leading to so many smaller companies struggling to make money. Investors should also worry that their willingness to tolerate losses at companies promising growth has allowed many new businesses to finance losses well beyond what's justified.

Write to James Mackintosh at James.Mackintosh@wsj.com