

Land of the corporate giants

The Economist

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Economies of scale

Economies of scale run out at a certain point. The largest firms in America may be beyond it

Getting bigger

- Something only get bigger, eg., skyscrapers and shopping malls
- In some cases, like boats, greater size promises greater efficiency, as fixed costs are spread over higher output

Container ships

- Container ships provide a good example of economies of scale in action
- In 1950s, the first ships could carry 480 TEU (20-foot equivalent) container, a new range of 18,000 TEU ships is due to launch in 2013

Tall building

- Between 1931 and 2007, world's tallest building rose from 381 to 828 metres
- As the building get taller, the fixed cost of land per square metre of office space falls
- But the wind force on a building rises exponentially with height, design and construction becomes more costly
- Study suggests that most very tall building are at an inefficient scale

Bigger corporations

- Long-run trend seems to be towards bigger companies (Lucas, 1978)
- The world's biggest firms keep on getting bigger
- How? Gradually, or suddenly as firms merge
- So are businesses like boats **or** buildings: are they seeking out economies of scale, or are they too big to be efficient?
- Economies of scale: average costs fall as a firm grows bigger

Bigger corporations

Firming up

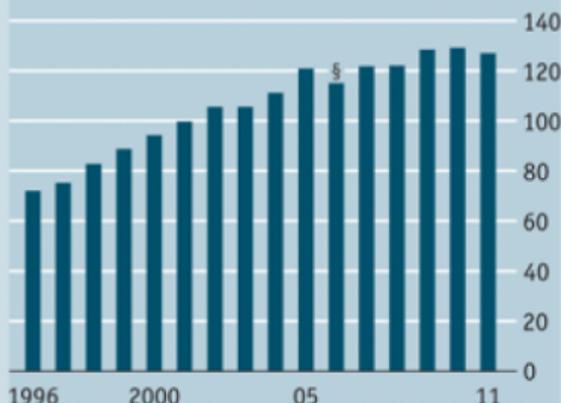
US, average number of workers per firm*



Sources: Historical Statistics of the United States; *Fortune*; Bloomberg; IMF; *The Economist*

US, biggest 50 firms†

Assets as % of GDP



*Non-farm †Series ends ‡By assets, based on biggest 500 firms by revenue, excluding government-sponsored enterprises §New series

- Firms are getting bigger and producing more output

To answer this question

- How to answer this question? Estimate **cost function**
- But cost function can be tricky to establish
- Studies show that some very large firms have reached the limits of scale

Why expanding?

- If so, why do big firms keep expanding?
- One possibility: seeking to boost profits not by driving down costs but by **raising prices**
- Buying up rivals softens competition and enables firms to charge more.
- There are evidences from health-care mergers.

Too-big-to-fail

- Some firms may be growing not to lower cost but to receive the comfort of implicit state support, eg., big banks (too big to fail)
- So antitrust authorities should be much more sceptical about mergers that claim to be justified because of economies of scale